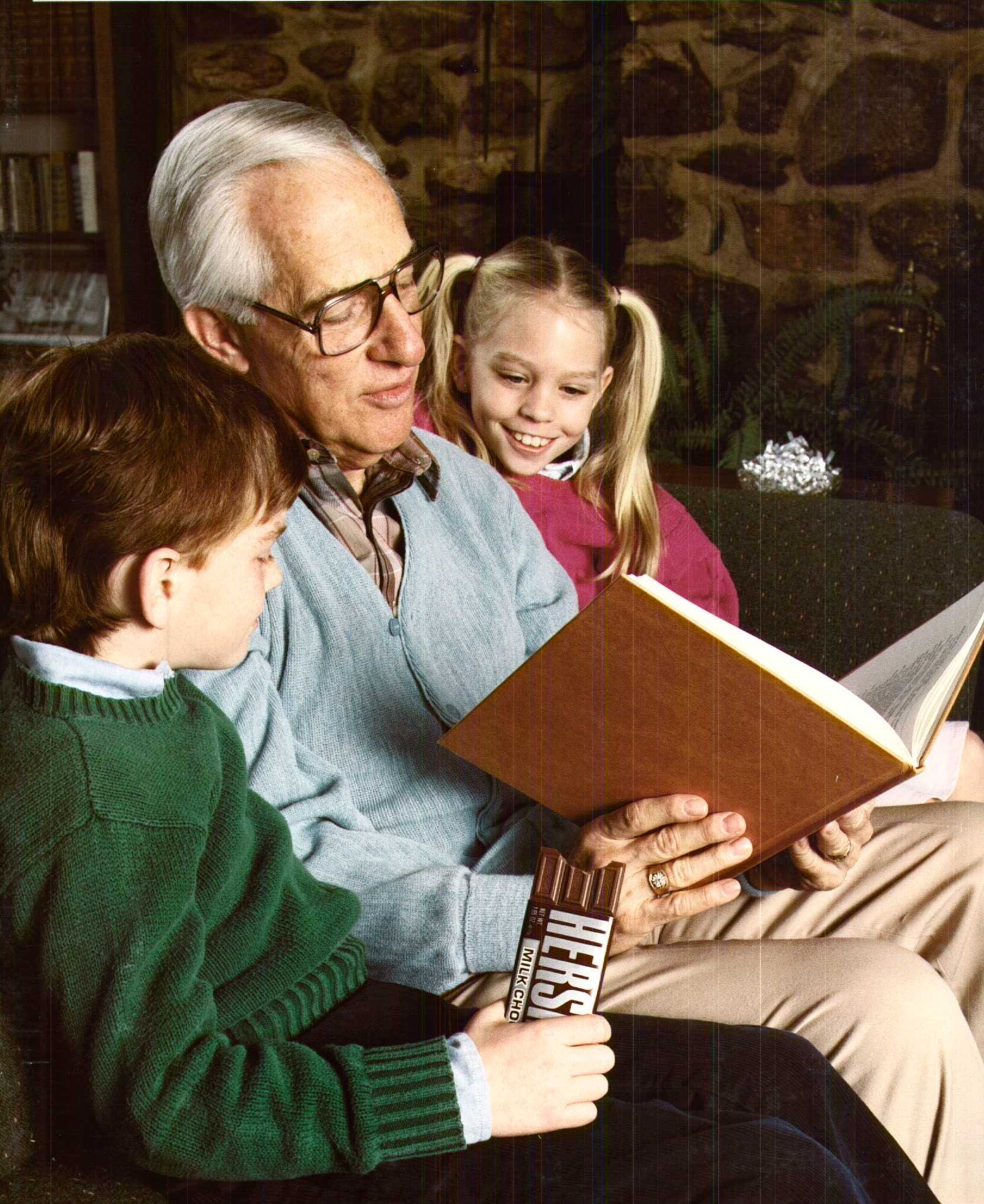
Hershey Foods Corporation

1988 ANNUAL REPORT



Hershey Foods Corporation

Hershey Foods Corporation, which includes Hershey Chocolate U.S.A., Hershey Canada Inc., Hershey International and Hershey Pasta Group, produces a broad line of chocolate, confectionery and pasta products. Hershey Chocolate U.S.A.'s principal brands include *Hershey's, Reese's, Y&S, Luden's* and *Peter Paul*. Hershey Canada's major brands, in addition to *Hershey, Reese* and *Y&S*, include *Oh Henry!, Life Savers, Lowney, Moirs* and *Planters*. Hershey International's business consists primarily of export sales and marketing of chocolate and confectionery products manufactured by Hershey Chocolate U.S.A., and joint venture operations in foreign countries. Hershey Pasta Group produces eight regional brands: *San Giorgio, American Beauty, Skinner, Delmonico, P&R, Perfection, Light 'N Fluffy* and *Pastamania*. Distributed throughout the continental United States, with the exception of Florida and portions of New England, the Pasta Group's brands are recognized leaders in their individual regions.

Contents

1988 FINANCIAL HIGHLIGHTS

(in thousands of dollars except shares and per share amounts)

	1988	1987	Percent Change
Net sales	**$2,168,048**	$1,863,816	+16
Income from continuing operations	**144,506**	124,074	+16
Net income	**213,949**	148,171	+44
Income from continuing operations per share	**1.60**	1.38	+16
Net income per share	**2.37**	1.64	+44
Cash dividends paid per share:			
Common Stock	**.660**	.580	+14
Class B Common Stock	**.595**	.525	+13
Total cash dividends paid	**58,530**	51,467	+14
Capital additions	**101,682**	68,504	+48
Stockholders' equity at year-end	**1,005,866**	832,410	+21
Price per share of Common Stock at year-end	**26.00**	24.50	+6
Net book value per share at year-end	**11.15**	9.23	+21
Outstanding shares at year-end	**90,186,336**	90,186,336	—

Net sales, income from continuing operations, income from continuing operations per share and capital additions amounts for 1987 have been restated for discontinued operations. Total shares of 90,186,336 were outstanding throughout the two-year period and, at December 31, 1988, consisted of 74,907,032 shares of Common Stock and 15,279,304 shares of Class B Common Stock. Income from continuing operations per share and net income per share are based on weighted average outstanding shares of 90,186,336 for 1988 and 1987. Net book value per share is based on outstanding shares at year-end for the applicable year.

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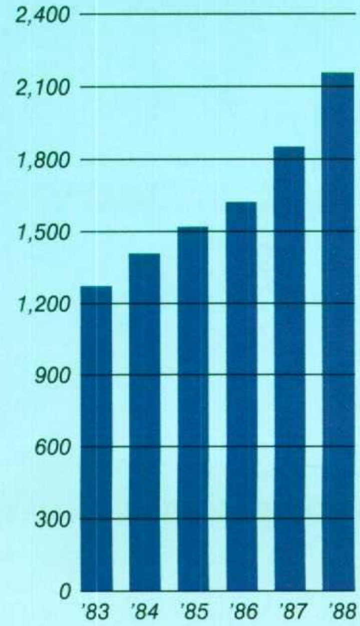
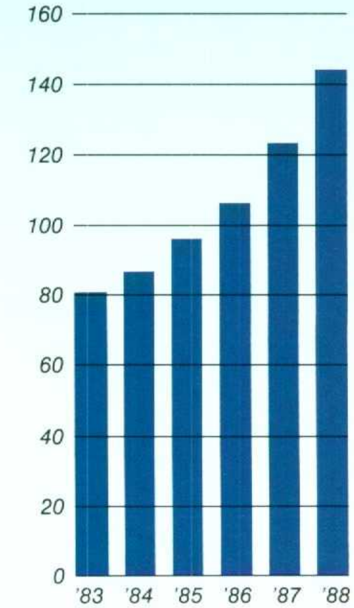
NET SALES

(dollars in millions)



INCOME FROM CONTINUING OPERATIONS

(dollars in millions)



As your Corporation faces the future, it is much better focused to achieve a higher rate of profitable growth.

Nineteen eighty-eight was a year of significant change for Hershey Foods Corporation. During the year, a restructuring of our business portfolio was effected through the purchase of Cadbury Schweppes' U.S. confectionery operations (Peter Paul/Cadbury) and the sale of Friendly Ice Cream Corporation. As your Corporation faces the future, it is much better focused to achieve a higher rate of profitable growth.

All of our continuing operations achieved record sales and earnings as well as market share growth in 1988. Earnings from continuing operations increased 16 percent on an equivalent sales increase.

The Peter Paul/Cadbury purchase on August 25, 1988, provided an excellent opportunity to enhance our confectionery business in the United States, as it propelled Hershey Chocolate U.S.A. into the leadership position in the total U.S. confectionery market. The purchase was consistent with the objective to acquire and license product lines which complement and expand our confectionery business.

The decision to sell Friendly was based upon a continuing review of the Corporation's strategic plan and an evaluation of its business portfolio. We felt the Corporation's resources would be employed better if directed away from the restaurant business. Friendly's business requirements were quite different from our major strengths in manufacturing and marketing food products. The restaurant chain's growth would have continued to require large amounts of capital, and we believed that capital would be more productive in our mainstream businesses.

Hershey Foods remains committed to its mission to become a major diversified food company and a leading company in every aspect of its business. In becoming the leading confectioner in its North American markets, the Corporation has made three significant acquisitions during the last three years: the Peter Paul/Cadbury business; the Canadian confectionery and snack nut businesses of Nabisco Brands Ltd. in mid-1987, and the Luden's business in late 1986. Each of these transactions had a key determinant which made it distinctly different from the others while presenting an opportunity to take advantage of the Corporation's basic strengths.

When Luden's confectionery business was acquired in October 1986, we rationalized the product lines and plant facilities to concentrate on four main brands: *5th Avenue* candy bar, *Luden's* throat drops, *Mello Mint* peppermint patties and *Queen Anne* chocolate covered cherries. The driving factor in this transaction was our perceived ability to expand distribution of these brands, a step we have undertaken.

There were two factors which motivated the Canadian acquisition. First was the need to achieve sufficient size in the market to have a meaningful presence. Following the acquisition, Hershey Canada became the leading confectionery and snack nut purveyor in Canada and attained a significant share in the all-important candy bar market. The net effect was to triple Hershey

Richard A. Zimmerman

Kenneth L. Wolfe

Canada's sales volume and give us a broad array of products to offer the Canadian consumer.

The other factor motivating this acquisition was the significant underutilization of chocolate production capacity which existed in Canada. A rationalization of Hershey Canada's excess production capacity is under way, and the program should enable our Canadian business to approach the operating margin currently enjoyed by our domestic confectionery business.

In deciding to make the Peter Paul/Cadbury purchase, we saw an opportunity to improve dramatically its operating margin through a reduction in manufacturing, selling, marketing and administrative expenses. The Cadbury Schweppes confectionery operation in the U.S. faced the usual difficulties associated with being a relatively small participant in a large, competitive market. The marketing and distribution costs prevented Cadbury from achieving desired margins.

Hershey Chocolate U.S.A. brings a wealth of experience in manufacturing, selling, marketing and distributing confectionery products in the United States to the Peter Paul/Cadbury acquisition. Additionally, the Division, with a larger organization, is well-positioned to provide for the selling, marketing and administrative needs of the Peter Paul/Cadbury business at a lower total cost. While the cost savings and corresponding margin improvements will not be effectuated fully until 1990, progress in this area has been realized already and the integration effort is proceeding extremely well.

Longer term, we expect that the new business configuration will bring us better returns and greater financial strength. Also, it should be noted that the current configuration of Hershey Foods is a snapshot at a particular point in time in our evolution toward becoming a larger, more profitable company. We will continue to look for appropriate acquisitions in the kinds of consumer-branded food businesses which will allow the Corporation to leverage its strengths as well as those of the acquired businesses.

Marketing activities continue to be an important factor in creating an atmosphere in which the Corporation can deliver efficiently its products to the vast consumer market it serves. Our 1988 marketing expenditures grew significantly compared with 1987 as we continued to support our established products, introduce new products, and provide marketing support to acquired businesses. In 1987 and 1988, marketing spending was 14.4 percent and 15.2 percent of sales, respectively. As the new businesses are integrated completely, the rate of spending growth should be reduced somewhat. However, we expect to continue to invest significantly in marketing activities.

New products continued to be an important source of growth in 1988 with *Bar None* candy bar and *Hershey's* chocolate milk mix leading the effort on a national basis. In addition, expanded distribution was achieved for *5th Avenue* candy bar. *Symphony* chocolate bar, which is currently being tested in California,

has been successful to date. The new year promises to be another exciting period featuring new product introductions on a national basis as well as a variety of test market efforts. The Corporation currently has the largest backlog of new products in various stages of development and testing in its history.

Expansion of territory continued for our pasta business and resulted in record sales in both tonnage and dollars as well as record income. Raw material costs escalated during the year, but Hershey Pasta Group maintained its 100 percent durum wheat formulation. Quality of product remains key to continued brand growth. The strategy of positioning our brands as leaders in quality has been followed successfully by Hershey Foods during its 22 years in the pasta business.

Significant capital investment is required in order to produce top quality products as well as to continue to gain in productivity. In our ongoing effort to be the quality, low-cost producer in our primary markets, we plan to invest heavily in capital over the next several years. These funds will support new product introductions, add capacity for existing products, and continue the modernization process at all manufacturing locations.

Although the cash demands of our business are high, we have been successful in achieving a balance between reinvestment in the business and dividend income to stockholders. In September, the Corporation's dividend rate was increased, marking the 14th consecutive annual dividend increase. Hershey Foods Common Stock holders received $.66 per share in 1988, as compared with $.367 per share in 1983, an increase of 79.8 percent.

Richard T. Baker, consultant for Ernst & Whinney, retired from the Board of Directors on April 25, 1988. We acknowledge the valuable contributions he made during his ten years of service to the Corporation. On April 25, 1988, Kenneth V. Hatt, Chairman of the Board of Hershey Trust Company, was elected to the Board of Directors. We welcome the wealth of knowledge and experience he brings to our Board of Directors.

In December, William F. Christ was named President, Hershey International. Mr. Christ previously was Vice President, Finance and Administration for Hershey Chocolate U.S.A. and filled a similar role for the International Division from 1979 to 1984.

As a result of our restructuring, Hershey Foods will be a slightly smaller company in terms of sales for the immediate future. However, we are confident that by 1991 the restructured Corporation will be generating higher income levels than in its previous configuration. An important reason for this confidence is the excellent quality of our employees, most of whom also are stockholders of the Corporation. Approximately 85 percent of our employees hold over 1.8 million shares of Hershey Foods Common Stock.

Stock ownership helps our employees share a common interest in the long-term growth of the Corporation. This common interest, plus their dedication and loyalty, have generated substantial productivity improvements year after year. These important productivity gains have been a key ingredient in our profitable growth and will help ensure our future competitive strength. We salute Hershey Foods' employees and thank them for their efforts.

Richard A. Zimmerman
Chairman of the Board and
Chief Executive Officer

Kenneth L. Wolfe
President and Chief
Operating Officer

The products manufactured by Hershey Foods represent a continuing dedication to superior quality and value — a commitment established by our unique founder, Milton S. Hershey. He believed in making the highest quality products at an affordable price, ensuring consumers the best value for their money.

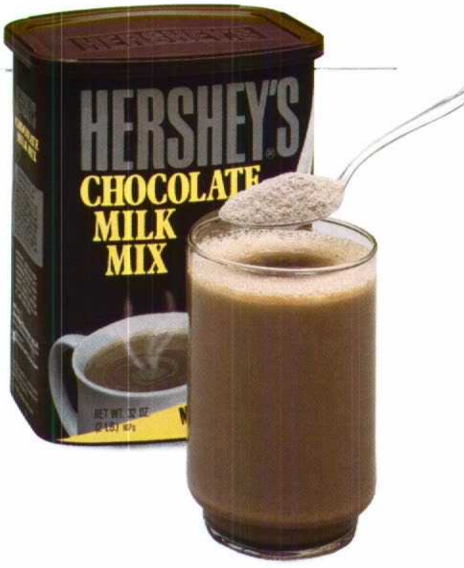
This commitment to quality is a top priority at Hershey Foods, one that goes beyond the comprehensive quality assurance program that governs product quality and safety. Attention to quality is an integral part of every job, enriching every aspect of the organization. It means leadership in satisfying our customers' requirements and building successful, long-term relationships with them. It's the attention given to procuring the finest ingredients from around the world, combined with modern, efficient manufacturing processes. It can be seen in our continuing efforts to attract, hire and develop outstanding employees. And it's evident through philanthropic contributions, provided to communities in which we operate and to society in general, that enrich the quality of life for our employees and their fellow citizens.

This commitment to quality is neither a luxury nor a simple heirloom from our corporate past; it's an absolute necessity if we are to survive and prosper in today's business environment. Competition among companies has intensified as expectations among customers and consumers continue to rise. We have long recognized these facts and have made the enhancement of quality and value key fundamentals of the Corporation's strategic plan.

"Quality Through Excellence" workshops at various Hershey Foods locations stress the importance of making everyone responsible for quality by teaching employees what quality means, why it matters and how to attain it. These workshops, along with other programs, help instill a "customer orientation" in all facets of work, encourage continuous improvement, reward initiative, and facilitate problem solving by individuals as well as by teams of employees at all levels.

Commitment to quality on the part of every employee is vital to continuing Hershey Foods' reputation for excellence in products and services. Quality and value will remain the foundations on which we build an even more successful future.


Nutty
Walnut Skins
Impact



Hershey Chocolate U.S.A.

Hershey Chocolate U.S.A. achieved a major milestone in 1988 as it attained the leadership position in the chocolate and confectionery category of the confectionery/snack foods market in the United States. Over the last several years, aggressive marketing programs, new product introductions and acquisitions have moved Hershey Chocolate U.S.A. steadily upward in market share. The August 25, 1988, acquisition of the operating assets of Cadbury Schweppes' U.S. confectionery operations (Peter Paul/Cadbury) vaulted Hershey Chocolate U.S.A. into the market leadership position.

Aided by the Peter Paul/Cadbury acquisition, Hershey Chocolate U.S.A. achieved record sales and operating income in 1988, a year in which market growth slowed slightly. The total sales increase was fueled by volume growth exceeding the industry average.

Confectionery sales gains were the result of real volume growth from existing brands, new products and the acquisition of Peter Paul/Cadbury. There were no major price increases during the year. Confectionery market share increased in all major classes of trade.

Grocery sales were mixed. *Hershey's* syrup achieved good results, while baking ingredients sales were hampered by the continuing trend of consumers moving away from scratch baking.

The increase in operating income resulted from sales volume increases, relatively stable commodity costs, and continued productivity gains in the manufacturing area. The operating margin declined somewhat, partly as a result of a lower Peter Paul/Cadbury margin during the transition period.

The Division invested significantly in marketing during the year to support its confectionery and grocery product lines. These marketing expenditures related to product introductions, responses to competitive activity, and market share growth. Marketing expenditures also increased as a result of the Peter Paul/Cadbury acquisition.

In Hershey Chocolate U.S.A.'s established business, record brand performances were attained by *Reese's* peanut butter cups, *Kit Kat* wafer bar, and *Hershey's Kisses* chocolates. Also, a very strong performance was recorded by *Whatchamacallit* candy bar, as consumers continued to respond positively to the increased bar weight and the addition of caramel in late 1987.

Bar None candy bar, the most recent new product entry, exceeded expectations in 1988, its first full year in national distribution. This unique combination of chocolate tastes and textures, featuring chocolate wafers, chocolate creme and peanuts covered with *Hershey's* milk chocolate, played a major role in the Division's success in 1988.

Symphony, a new, milder and creamier chocolate bar, entered test market on the West Coast in January 1988. Offered in two flavors, milk chocolate and milk chocolate with almonds and toffee chips, this new chocolate bar has performed quite well in the initial testing stages.

5th Avenue, a candy bar containing several layers of crunchy peanut butter covered with milk chocolate, is an example of Hershey Chocolate U.S.A.'s proven ability to acquire quality regional brands and create a national franchise for them. While it represents a well-known brand name in the Northeast, this product was distributed only on a limited basis in other parts of the country prior to 1988. *5th Avenue* received

Senior Scientist Irv Smalls and Senior Food Technologist Bo-Juie Hom of Hershey Foods' Research and Development staff are among many trained taste panel members who evaluate and compare new products being considered for manufacture. Here, they identify subtle differences in flavor and fragrance quality, while helping to maintain the distinctive Hershey's taste in all finished products.

The ability to acquire top-quality businesses which complement existing operations was shown again when Hershey Foods purchased the U.S. confectionery operations of Cadbury Schweppes Inc. in August 1988. Here, Ray Brace (left), Vice President, Manufacturing, Hershey Chocolate U.S.A., and Jack Tatigian, Vice President, Peter Paul, check production of Peter Paul Almond Joy *bars, one of several Peter Paul/Cadbury products which Hershey Foods now has the license to manufacture, market and sell. In the foreground: line operators Catherine Hampton (left) and Barbara Jannetty.*

Hershey Chocolate U.S.A.'s innovative marketing campaigns not only help enhance sales of new and established brands but also reinforce the quality reputation behind the Hershey's *name. Here, Brands Manager Bill Stamey (center) discusses the new national advertising campaign for* 5th Avenue *candy bar with Associate Brands Manager Yasmin Jones (standing), Senior Marketing Research Analyst Ken Hollingsworth and Dorothy Kirejczyk, Manager, Sales Planning.*

its first true national introduction in September 1988 with the equivalent of new product trade and consumer marketing support.

Hershey's syrup, in the Division's grocery products category, continues to perform well with both sales and market share exceeding the previous year's levels. On the new products front, the national introduction of *Hershey's* chocolate milk mix was completed during the fourth quarter. This product is an instant hot or cold milk mix which dissolves quickly and thoroughly in milk to produce a chocolate drink. It replaces *Hershey's Instant* mix in an effort to capture a greater portion of the $200 million powder-additive category of the beverage market.

Golden Almond Nuggets chocolates, which were introduced in selected test markets during 1987, were expanded into national distribution in September 1988. In addition, the *M.S. Hershey* boxed chocolate line was tested in key drugstores throughout the United States in the fall of 1988 as another possible entry in Hershey Chocolate U.S.A.'s premium confectionery line.

Major capital spending projects in 1988 were directed toward enhancing production capacity for established and new products and toward improving productivity. Compared with 1987 totals, capital additions were approximately 30 percent higher. The Corporation expects to allocate capital to the Division well above historical spending levels as it

Peter Paul/Cadbury

The Peter Paul/Cadbury operation, like Hershey Foods itself, traces its heritage back to the vision and determination of individual entrepreneurs in the 19th and early 20th centuries.

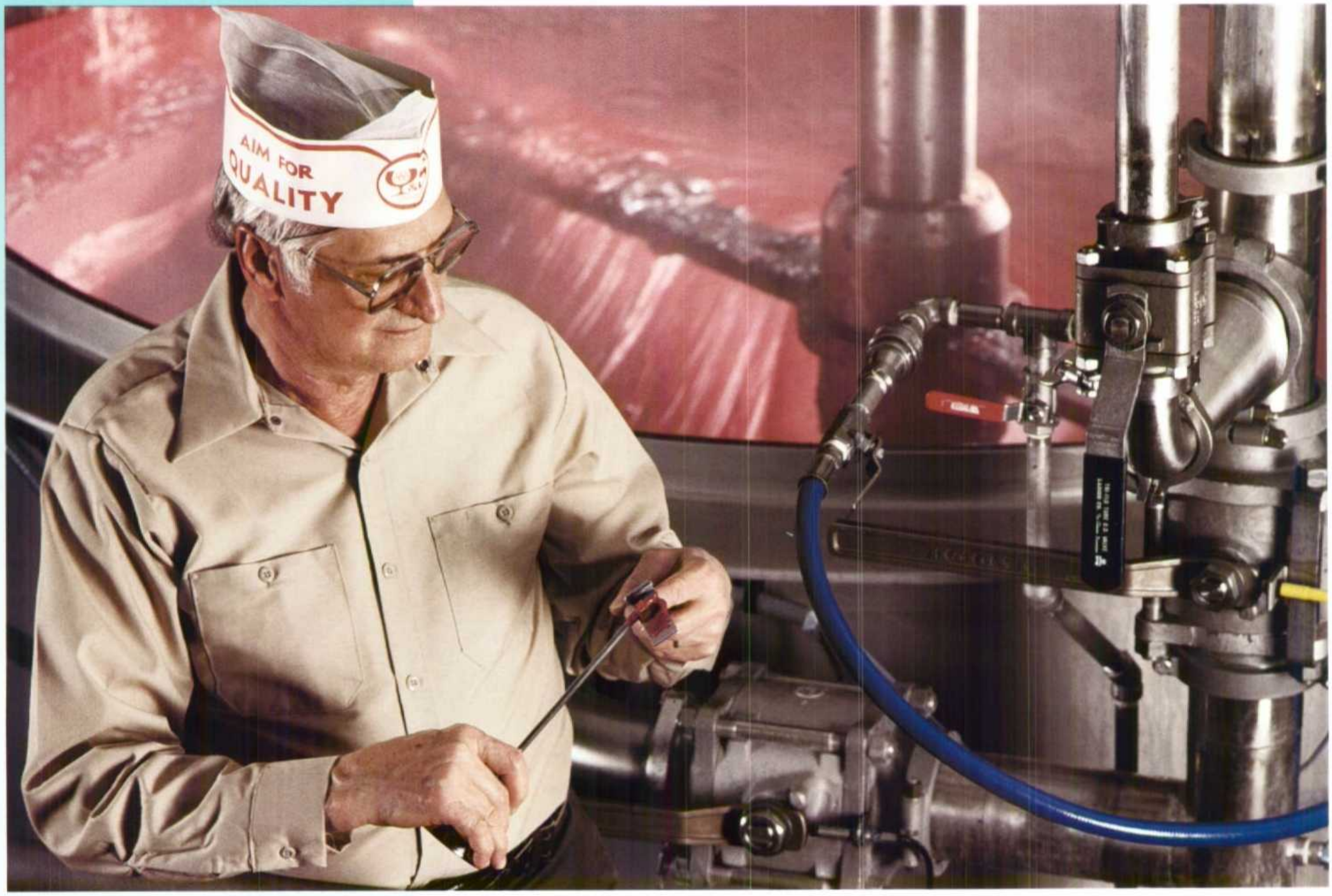
Cadbury is one of the oldest confectionery businesses in the world. It dates back to 1824, when John Cadbury, a merchant in Birmingham, England, began selling cocoa drinks and chocolate products as a sideline to his coffee and tea business. Cadbury introduced its first confectionery products as early as 1842. *Cadbury's Dairy Milk* chocolate, a successful brand both at home in England and abroad, was introduced in 1904.

The Peter Paul firm got its start in 1919, when Peter Paul Halajian moved his home-based chocolate business into a small shop in New Haven, Conn. He and his five business associates, all of Armenian heritage, produced chocolates at night and sold them door-to-door the following day. *Peter Paul Mounds* candy bar, with its combination of sweetened coconut and dark chocolate, was an early success. *Peter Paul Almond Joy* candy bar followed in 1947. *York* peppermint pattie was added in 1972 when the Peter Paul firm acquired the York, Pa., operation.

As in its 1986 acquisition of the Luden's operation, Hershey Foods has been fortunate in acquiring businesses which share a heritage similar to its own. Peter Paul/Cadbury's long-standing commitment to quality and value makes it a welcome addition to the Hershey Foods family.

Hershey Chocolate U.S.A.'s success at maintaining high levels of customer service was highlighted when a panel of 20 major wholesale companies selected the Division to receive the U.S. Distribution Journal's Supplier Excellence Award as the outstanding supplier for 1988. Here, Hershey Chocolate U.S.A. Sales Representative John Grimm (left) meets with a K mart store manager. K mart, with more than 2,100 stores nationwide, is one of Hershey Chocolate U.S.A.'s largest customers.

Hershey Chocolate U.S.A.'s chocolate and confectionery production lines include quality checks throughout the manufacturing process. Here, Cookmaster John Story monitors the temperature of Y&S licorice candy mixture to ensure cooking consistency.



continues to invest in additional capacity and more efficient equipment.

Hershey Foods' purchase of the operating assets of Cadbury's U.S. confectionery business included plants in York and Hazleton, Pa., and Naugatuck, Conn. In addition, the Corporation entered into license agreements to manufacture and/or market and distribute in the United States Peter Paul/Cadbury confectionery brands which include *Mounds, Almond Joy, York* peppermint pattie, *Dairy Milk, Fruit & Nut, Caramello,* and the Easter specialty items *Creme Eggs* and *Mini-Eggs,* and to manufacture, market and distribute the *Mounds* and *Almond Joy* brands worldwide.

Peter Paul Mounds, Peter Paul Almond Joy and *York* peppermint pattie are three very significant brands which rank among the top 20 in the United States and which complement the Corporation's existing confectionery lines. *Cadbury's Creme Eggs* provides an excellent item for the important Easter holiday season, while *Caramello* is a product with excellent potential.

Going forward, Hershey Chocolate U.S.A. believes it can make substantial improvements in the profit contribution from the Peter Paul/Cadbury brands through efficiencies in manufacturing, selling, marketing and administrative areas. The production space and modern equipment available at the Hazleton plant will help the Division meet future capacity requirements of its expanding business. As a step toward achieving the desired efficiencies, a decision was made in 1988 to discontinue operations at the York plant in late January 1989 because the facility was very old and not conducive to modernization. Production of the *York* peppermint pattie products has been shifted to the Division's plant in Reading, Pa.

Overall, integration of the new operation essentially is complete. Shipments of Peter Paul/Cadbury products within the Hershey Chocolate U.S.A. distribution system began in mid-November 1988 along with the transfer of sales responsibilities from a network of food brokers to the Division's sales force. In mid-December 1988, all data processing and support systems were transferred to Hershey, Pa.

Hershey Canada Inc.

Hershey Canada Inc. achieved record sales and operating income in 1988, primarily resulting from the first full year of operation of the confectionery and snack nut businesses acquired in 1987 from Nabisco Brands Ltd. and from solid growth in established businesses.

These results also reflect a strengthened Canadian dollar in 1988. By year-end 1988, the Canadian dollar had increased to approximately $.838 U.S., nearly a six-year high. The strength of the Canadian dollar is attributed to general economic conditions and to enactment of the Canada-U.S. Free Trade Agreement.

While operating income achieved a record level in 1988, it did not increase at a rate equal to sales growth because of heavy marketing expenditures required to meet competitive challenges.

The Canadian confectionery market strengthened during 1988, recovering some of the decline experienced following the 1985 imposition of a Canadian Federal sales tax on confectionery products. To date, however, the market has not recovered to levels experienced prior to 1985. The salted snack market in which the *Planters* nut products compete also has experienced a significant decline since the imposition of a Canadian Federal sales tax on this category in mid-1987.

In general, the Canadian confectionery industry has been extremely competitive, resulting in rationalization of excess capacity, introduction of newer manufacturing technologies, and consolidation among manufacturers. In addition to Hershey Canada's 1987 acquisition, there have been two other major confectionery acquisitions among competitors within the past two years.

In this environment, Hershey Canada has maintained its market share leadership positions in the hard roll candy, peanuts, licorice and baking chip categories, and has strengthened its respective number two and number three positions in the boxed chocolates category and the important chocolate bar category.

The Canadian chocolate bar category of the confectionery/snack foods market grew by approximately 3 percent during 1988, attributable

to increased levels of trade and consumer promotional activity in the industry and to a partial recovery of the decline in industry volume resulting from the Canadian Federal sales tax. Hershey Canada increased its market share, with five brands in the top-20 selling category: *Oh Henry!* candy bar, *Reese* peanut butter cups, *Glosette* chocolate covered peanuts and raisins, *Skor* toffee candy bar and *Eatmore* candy bar.

Temptation candy bar, launched in November, was the major new product introduction in 1988. Produced by Hershey Chocolate U.S.A., which distributes it in the United States under the brand name *Bar None, Temptation* has achieved excellent acceptance in the market place. Also introduced in the Canadian market in 1988 were two new *Life Savers* candy flavors. *Ovation* mint sticks, an established Canadian product, is being test marketed in the United States.

Effective January 1, 1989, the selling price of most standard bar items was increased. The normal retail price of a standard bar rose from Cdn. $.65 to Cdn. $.70 in most outlets.

The competitive environment, including free trade opportunities, places particular importance on Hershey Canada's goal of becoming the low-cost, quality producer in Canada. To achieve this goal, a major focus during 1988 was the continued integration and rationalization of acquired operations. A number of enhancements were made, as part of this process, to the sales, marketing, distribution and administrative functions during the year. In addition, in November 1988, Hershey Canada sold the Canadian trademark rights to its gum and chewy candy business together with the related plant in Amherst, Nova Scotia.

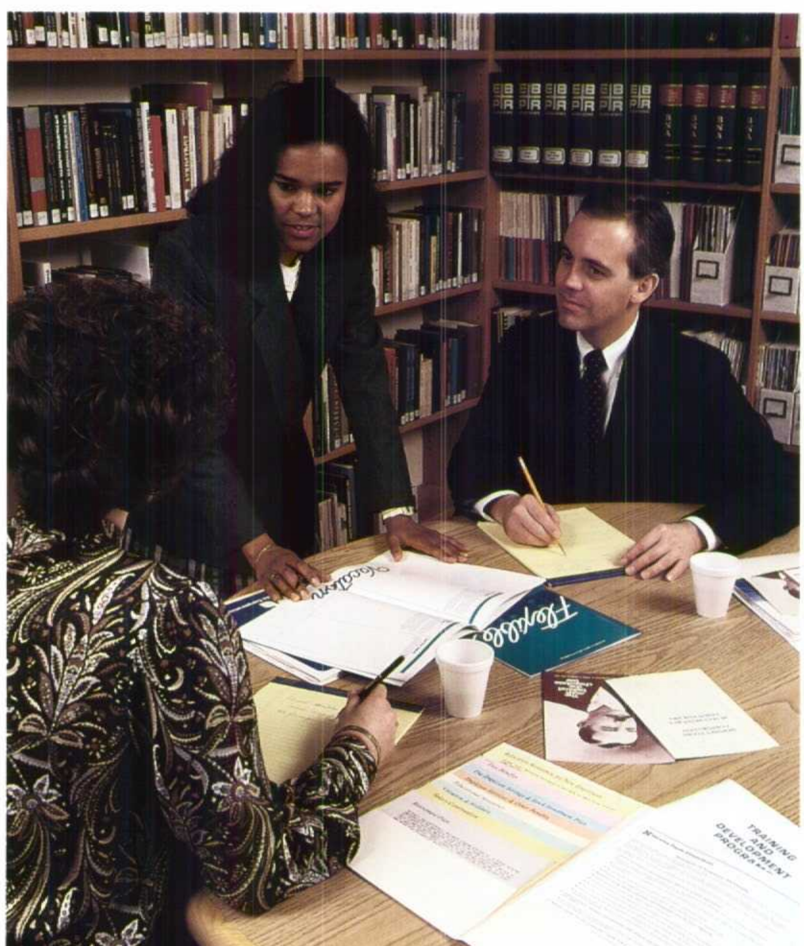
In the manufacturing area, the previously-announced closing of the Planters Toronto facility and relocation of its manufacturing operations to a newly-opened expansion of the Smiths Falls, Ontario, facility was completed. Efforts to relocate employees or to place them with other employers in Toronto were successful. Planters manufacturing operations in Smiths Falls began in August after being delayed for approximately two months by construction labor strikes, and operations now are in line with production expectations. A key benefit of this relocation was the opportunity to introduce "just-in-time" manufacturing techniques in the new facility.

In September 1988, Hershey Canada implemented its second manufacturing rationalization move by announcing that the Lowney's plant in Sherbrooke, Quebec, would be closed during 1989 and that major production lines would be moved to other existing facilities, principally Smiths Falls. As in the Planters plant closing, all hourly employees have been offered the opportunity to relocate to Smiths Falls. The Sherbrooke facility is a 380,000-square-foot plant employing over 400 people. When completed, the relocation will result in a fully-utilized facility in Smiths Falls.

Manufacturing concentration in Smiths Falls also presents the opportunity for distribution cost savings while, at the same time, improving the quality of customer service. To realize these benefits, a 110,000-square-foot distribution

Hershey Chocolate U.S.A. procures the finest cocoa beans from more than a dozen different countries as a primary ingredient in chocolate production. Here, the Quality Tracking Team of Supervisor Paul Miller (left), Quality Assurance Technician Sovann Khlok and Operator Gary Bomgardner monitors the quality of cocoa beans entering production at the Hershey, Pa., plant. Groups of plant employees, including production workers, quality assurance representatives and maintenance personnel, meet routinely to help monitor production quality in all areas of operation.

Hershey Canada's continuing development of more productive, cost-effective manufacturing operations is key to maintaining a competitive business advantage. Here, Plant Manager Burke Macgillivray (left) and Packaging Supervisor Mike Garvey check production in the newly-opened, 70,000-square-foot expansion of the Smiths Falls, Ontario, Canada plant, designed to accommodate manufacturing equipment for Planters *peanuts production.*



The ability to train and develop employees is critical to any organization's success in today's competitive business world. Hershey Foods has a successful development program for all employees and maintains an active equal opportunity recruitment program, both designed to fill its need for qualified employees in the years to come. Here, Human Resources Representative Paula Waters (center) conducts an orientation session for new employees Frank Day, Senior Econometrician, Commodities Department, and Kathleen Purcell, Legal Secretary, Law Department.

center is under construction. With completion anticipated in mid-1989, this facility will serve mainly customers in the important Ontario and Quebec markets.

Hershey International

Hershey International achieved record export sales in 1988 resulting from strong promotional campaigns and the continued weakness of the U.S. dollar in most of its foreign markets. Sales were led by shipments to Japan, South Korea and other Far East locations. Exports continued to expand in Eastern Europe and the duty-free zones in Latin America.

Hershey International's joint venture in Mexico, Nacional de Dulces, S.A. de C.V., reported increased earnings in 1988 compared with 1987. Despite a difficult economic environment in which the confectionery market contracted, Nacional de Dulces improved its operating performance through stringent cost controls, automation and other productivity improvements. During 1988, Hershey International's former partner, Unilever, sold its 50 percent interest in Nacional de Dulces to the Carlos Slim Group. The Slim Group, a conglomerate with other international joint venture partners, is committed to expanding distribution of the *Hershey's* confectionery brands and to increasing market share.

The Division's joint venture affiliate in the Philippines, Philippine Cocoa Corporation, reported a strong increase in earnings compared with 1987. Volume growth and market share gains were achieved in the premium quality *Hershey's* milk chocolate brands as well as in other confectionery brands marketed under the *Goya* trademark. Several capital projects were initiated in 1988 that will enable this affiliate to expand production capacity to meet expected demand.

Petybon S.A., a joint venture with the Bunge Born Group in Brazil, manufactures and markets pasta, biscuits, margarine and *Brown Cow* syrup. These markets contracted in 1988 as Brazil's inflation exceeded 800 percent and greatly reduced consumer purchasing power. Nevertheless, Petybon increased volume and market share in the pasta and biscuit markets by utilizing raw material supply synergies and distribution gains obtained through the alliance with Bunge Born. In November 1988, Petybon entered into a joint venture to manufacture and market pre-cooked lasagne.

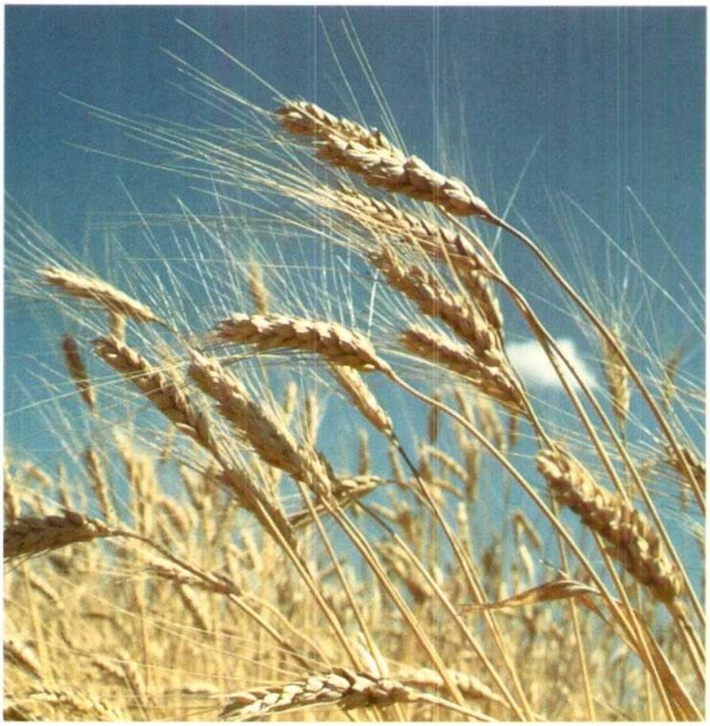
AB Marabou, an affiliate in Sweden, reported increased profits in 1988, reflecting growth in its chocolate and sugar confectionery, snack and biscuit product lines. In late 1988, Marabou purchased confectionery companies in Sweden and Denmark. The Danish acquisition provides an important entry for Marabou in the 12-nation European Economic Community. In 1988, Marabou became the leader in the Swedish sugar confectionery market, matching its leadership position in the chocolate confectionery market.

The Division's licensing operations continued to grow in 1988, most notably in South Korea. Volume of existing licensed product lines doubled, and the range of confectionery products was expanded to include *Special Dark* chocolate and *Harmony*, a coffee-flavored, creme-filled chocolate. Sales generated by the licensing venture with Fujiya Confectionery Co., Ltd. in Japan for *Hershey's* syrup and cocoa powder continued to expand.

Hershey Pasta Group

Hershey Pasta Group exceeded $200 million in net sales for the first time in 1988 and produced record sales for the tenth consecutive year. Sales dollar growth consisted of approximately one-third volume and two-thirds pricing. Real growth was two and one-half times the industry rate and reflected continued market penetration, new market expansion and

Hershey Pasta Group uses the finest 100 percent durum wheat as its primary ingredient in manufacturing. Despite last year's drought and its negative impact on supply and price, Hershey Pasta Group held the line against blending wheats to handle demand, reaffirming its commitment to producing only quality pasta products.



State-of-the-art pasta manufacturing equipment enables Hershey Pasta Group to produce efficiently such pasta specialty items as the jumbo shells shown here. Press Operator Sue Weiant checks the formation and cut length quality of the pasta during a routine line inspection.

the success of product line extensions for the Division.

Price increases were implemented by pasta manufacturers in the third quarter of 1988 in response to a rapid rise in raw material costs following the summer drought. Semolina and durum flour, the principal pasta ingredients, are milled from durum wheat grown primarily in North Dakota. The state of North Dakota and surrounding areas were among the regions most severely affected by the lack of rain this past spring and summer. Crop yields were less than 50 percent of normal and resulted in a rise in durum wheat spot prices on the Minneapolis Grain Exchange of over 65 percent from May to July 1988.

The raw material cost increases and the threat of raw material shortages led some pasta manufacturers to blend non-durum wheat with durum wheat. Hershey Pasta Group chose to maintain its commitment to quality using 100 percent durum wheat. As a result of these high quality standards, Hershey Pasta Group's products scored well in two independent consumer surveys.

The U.S. pasta industry enjoyed steady growth in tonnage sales despite rising retail prices. This was due to the introduction of innovative shapes and products and to aggressive competition and market expansion by key industry players.

Hershey Pasta Group achieved a record high market share of supermarket sales. This was aided in large measure by selling and marketing efforts directed at expansion into new markets. Key areas included the introduction of the *San Giorgio* and *Light 'N Fluffy* brands into the Chicago market, the *American Beauty* brand into Oregon and Alaska, and the *Perfection* brand into the San Francisco Bay area.

While all brands contributed to the Division's growth, particularly noteworthy was the continued growth of the *San Giorgio* and *P&R* brands in the high-consumption Northeast markets in the face of expansion efforts by a major competitor.

Product line extensions also played a key role in building momentum in supermarket sales. During the year several innovative new product items were introduced: *Trio Italiano* (rotini, shells and mostaccioli in a single package), *Fettuccine Florentine* (a classic spinach and egg fettuccine combination) and *Rainbow Medley* (three shapes, three flavors). All are finding a positive reception among new and long-time users of traditional pasta shapes.

Excitement about Hershey Pasta Group's products in supermarkets continued to grow, thanks to a series of in-store theme promotions. Supermarket managers expressed appreciation for the way Hershey Pasta Group continued to build sales not only for its brands but also for the category as a whole.

The Division continues to enhance productivity through a long-range program of plant modernization and consolidation. A major step took place in December 1987 with the closing of the Denver, Colo., facility and the transfer of its production requirements to other Hershey Pasta Group plants.

Increased production capacity was added in Fresno in 1988, with additional expansion planned for 1989. Other major capacity expansion programs are under way at Lebanon, Pa., Omaha, Neb., and Kansas City, Kan. Capital spending increased by over 75 percent in 1988, and comparable levels of investment spending are expected in 1989, 1990 and 1991.

Negotiations between the Office of the United States Trade Representative and the European Economic Community (EEC) resulted in a settlement of the pasta import issue in late 1987. The EEC agreed to eliminate the subsidy on half of its exports and to reduce the subsidy on the remaining half by 27.5 percent. As a result, Italian pasta imports in the U.S. declined nearly 4 percent in 1988. This followed growth of 25 percent in 1987.

Pasta imports from Turkey were the major import issue in 1988. These products did not appear on grocery store shelves until the second half of 1987 and have increased to ten million pounds annually. These imports resemble those of Italy in their product package appearance and labeling. ■

Summary of Consolidated Operating Results

The Corporation achieved significant growth in sales and income from continuing operations in 1988 and 1987. Net sales increased at a compound rate of 15% during this two-year period, while income from continuing operations grew at a compound rate of 16%. The sales gain primarily reflects unit volume growth from business acquisitions, existing brands and new product introductions. Higher selling prices for pasta products and appreciation of the Canadian dollar also had a slight impact on consolidated results during the two-year period.

The growth in income from continuing operations reflects the growth in sales, an increase in the gross profit margin and a lower effective income tax rate, partially offset by higher levels of selling and marketing, administrative and net interest expenses.

Summary of Financial Position and Liquidity

The Corporation strengthened its financial position in 1988 compared with 1987. The continuing operations ratio of current assets to current liabilities increased to 1.8:1 from 1.7:1 in 1987, and the capitalization ratio (total short-term and long-term debt as a percentage of stockholders' equity, short-term and long-term debt) decreased to 22% from 27% in 1987.

Cash and cash equivalents increased from $8 million at December 31, 1987, to $70 million at December 31, 1988. This increase primarily reflects cash generated from operating activities in excess of capital additions and dividend payments. Proceeds from the sale of Friendly Ice Cream Corporation were used principally to repay short-term debt incurred in financing the acquisition of the operating assets of Cadbury Schweppes Inc.'s U.S. confectionery business and repay debt assumed as part of the acquisition.

Over the three-year period ending December 31, 1988, the Corporation's net cash position decreased approximately $38 million and total debt increased $193 million. During this period, the Corporation invested heavily in business acquisitions and capital additions and, in 1986, purchased 3,825,000 shares of its Common Stock from its majority stockholder, Hershey Trust Company, as Trustee for Milton Hershey School (Hershey Trust).

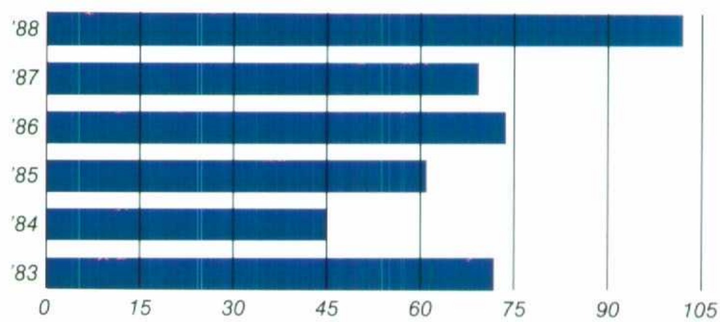
Acquisitions and Divestitures

Operating results during the two-year period were impacted by the following acquisitions:

- August 1988 — Acquired from Cadbury Schweppes Inc. and Cadbury Schweppes plc (Cadbury) the

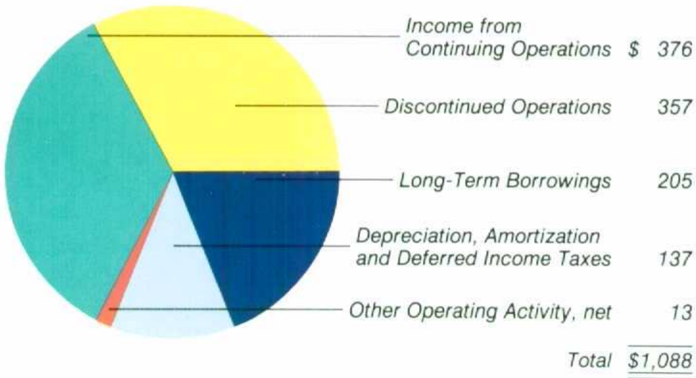
CAPITAL ADDITIONS

(dollars in millions)



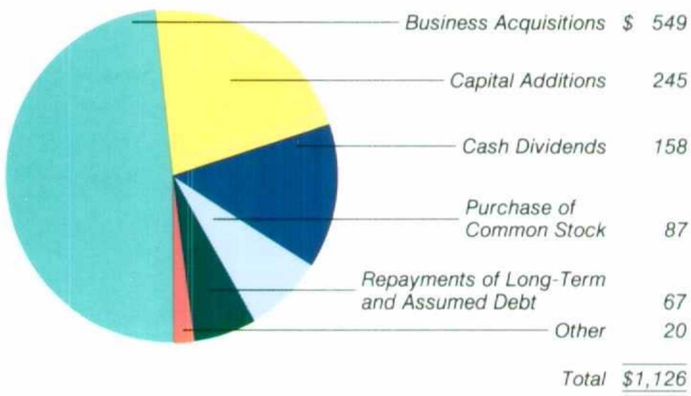
THREE-YEAR PRINCIPAL SOURCES OF CASH

(dollars in millions)



THREE-YEAR PRINCIPAL USES OF CASH

(dollars in millions)



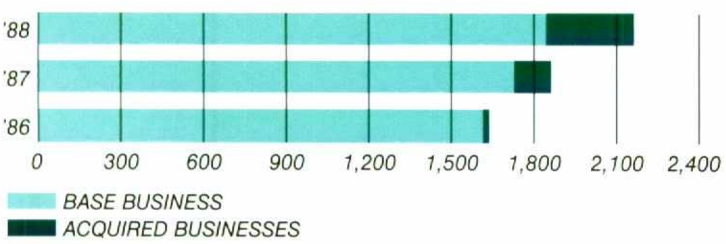
operating assets of Cadbury's U.S. confectionery business (Peter Paul/Cadbury) and entered into trademark and technology license agreements to manufacture and/or market and distribute Cadbury's confectionery brands;

- June 1987 — Acquired the assets and trademark rights of Nabisco Brands Ltd.'s Canadian confectionery and snack nut businesses (Canadian Confectionery Operation); and
- October 1986 — Acquired the outstanding capital stock of The Dietrich Corporation (Luden's).

A further discussion of these acquisitions can be found in Note 2 to the consolidated financial statements.

CONTRIBUTION TO NET SALES OF BUSINESSES ACQUIRED 1986 – 1988

(dollars in millions)



In September 1988, the Corporation sold all of the issued and outstanding capital stock of Friendly Ice Cream Corporation (Friendly). Accordingly, the financial statements have been restated for all periods presented, and management's discussion and analysis of results of operations, cash flows and financial condition focus on continuing operations. A further discussion of the sale of Friendly can be found in Note 3 to the consolidated financial statements.

As a result of the sale of Friendly, the Corporation has refocused its operations into one line of business — consumer foods, involving the manufacture, distribution and sale of chocolate, confectionery, pasta and other food products. The principal product groups sold are chocolate and confectionery products in the form of bar goods, bagged items, baking ingredients, chocolate drink mixes and dessert toppings, throat drops, and pasta products in a variety of different shapes, sizes and packages.

Other Significant Items

The most significant raw materials used in the production of the Corporation's chocolate and confectionery and pasta products are cocoa beans and durum wheat, respectively. Generally, the Corporation has been able to offset the effects of increases in the cost of these raw materials through selling price increases or reductions in product weights. Conversely, declines in the cost of these raw materials have served as a source of funds to enhance consumer value, respond to competitive activity and develop new products and markets.

The cost of cocoa beans and the prices for the related commodities futures have historically been subject to wide fluctuations attributable to a variety of factors including the effect of weather on crop yield, other imbalances between supply and demand and speculative influences. During 1988 the market price of cocoa futures declined significantly as a result of a worldwide excess supply. The market cost of cocoa beans also decreased but by a lesser amount because of a unilateral withholding of cocoa beans from the market by the Ivory Coast. The oversupply situation is expected to continue into 1989, resulting in a favorable impact on the Corporation's raw material costs. This favorable impact will not necessarily be consistent with quoted market prices because of the Corporation's forward purchasing practices and premiums and discounts reflective of relative values, varying delivery times and supply and demand for specific varieties and grades of cocoa beans.

Market prices for durum wheat increased dramatically during the middle of 1988 as a severe drought in the principal growing regions reduced crop yields. The 1988 harvest, in combination with prior years' carryover, is considered adequate to meet normal domestic demand and a reduced level of exports. A strong surge in export demand or a poor 1989 crop could trigger shortages and further raw material cost increases. It is expected that the Corporation's use of custom milling arrangements will continue to contribute to the maintenance of an adequate supply of high quality durum wheat.

Effects of Inflation

The Corporation monitors the effects of inflation and takes various steps, including selling price and product weight changes, to minimize its impact on the Corporation's business. The use of LIFO inventory accounting for most inventories matches current costs with current revenues and, in periods of inflation, reduces income taxes and improves cash flow. The capital expenditures program, through investment in modern plant and equipment, provides for future sales growth and manufacturing efficiencies. This approach to management of

inflation, the generally stable costs of most major commodities and other manufacturing materials, and the modest rate of inflation on other costs as measured by the Average Consumer Price Index, are the principal factors which have resulted in inflation having a minimal effect on comparative results of operations and financial condition for the most recent three years.

Capital Structure

The Corporation has two classes of stock outstanding, Common Stock and Class B Common Stock (Class B Stock). The Common Stock and the Class B Stock generally vote together without regard to class on matters submitted to stockholders, including the election of directors, with the Common Stock having one vote per share and the Class B Stock having ten votes per share. However, the Common Stock, voting separately as a class, is entitled to elect one-sixth of the Board of Directors. With respect to dividend rights, the Common Stock is entitled to cash dividends 10% higher than those declared and paid on the Class B Stock.

On November 14, 1986, Hershey Trust sold 5,175,000 shares of Hershey Foods Corporation Common Stock, $1.00 par value, in an underwritten secondary public offering. On the same date, the Corporation purchased 3,825,000 shares of its Common Stock from Hershey Trust at $22.72 per share, a price equal to the proceeds per share to Hershey Trust in the secondary public offering. The acquired shares were retired and became authorized and unissued shares of Common Stock.

Hershey Trust sold the shares in order to diversify its investment portfolio. Hershey Trust has indicated that, subject to its fiduciary obligations, it has no intention of selling any additional shares of the Common Stock and intends to maintain voting control of the Corporation. Hershey Trust currently is entitled to cast approximately 77% of the total votes of both classes of the Corporation's common stock.

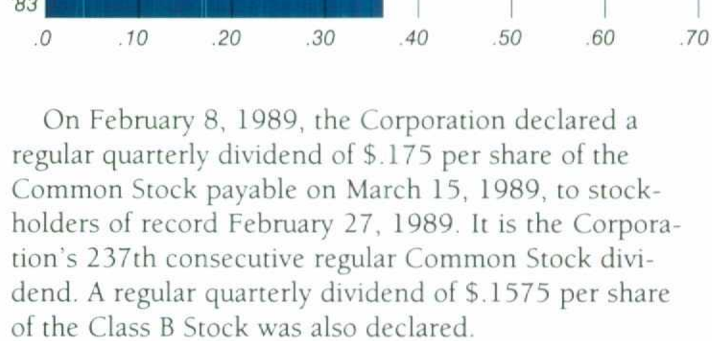
The Corporation's capital structure was grandfathered under the July 7, 1988, Securities and Exchange Commission (SEC) ruling concerning dual classes of common stock. The new SEC Rule 19c-4 (Rule) provides that no equity security of any issuer can be listed on a securities exchange or national market system if the company issues any class of stock or takes any corporate action that has the effect of nullifying, restricting or disparately reducing the per share voting rights of any class of common stock outstanding. Future issuances of stock by the Corporation are subject to the Rule. On September 2, 1988, the Business Roundtable filed notice in the U.S. Court of Appeals for the District of Columbia of its intention to challenge the SEC's promulgation of the Rule. If the Business Roundtable is successful, the Rule would be invalidated in whole or part. There have been no developments in this action to date, and the Rule remains in force pending the outcome of the Business Roundtable suit.

Market Prices and Dividends

Cash dividends paid on the Corporation's Common Stock and Class B Stock were $58.5 million in 1988 and $51.5 million in 1987. The annual dividend rate on the Common Stock is $.70 per share, an increase of 13% over the 1987 rate of $.62 per share. The 1988 dividend represents the 14th consecutive year of Common Stock dividend increases.

DIVIDENDS PAID PER SHARE OF COMMON STOCK

(dollars)



On February 8, 1989, the Corporation declared a regular quarterly dividend of $.175 per share of the Common Stock payable on March 15, 1989, to stockholders of record February 27, 1989. It is the Corporation's 237th consecutive regular Common Stock dividend. A regular quarterly dividend of $.1575 per share of the Class B Stock was also declared.

Hershey Foods Corporation Common Stock is listed and traded principally on the New York Stock Exchange under the symbol HSY. Approximately 46.7 million shares of the Corporation's Common Stock were traded during 1988. The market price of the Common Stock on the New York Stock Exchange (NYSE) at December 31, 1988 was $26. The Class B Stock is not publicly traded. There were 30,430 stockholders of record of the Common Stock and the Class B Stock at December 31, 1988.

The following table shows the dividends paid per share of Common Stock and Class B Stock and the price range of the Common Stock for each quarter of the past two years.

	Dividends Paid Per Share		Common Stock Price Range*	
	Common Stock	Class B Stock	High	Low
1988				
1st Quarter	$.1550	$.1400	$28\frac{3}{8}$	$22\frac{7}{8}$
2nd Quarter	.1550	.1400	$26\frac{1}{4}$	$21\frac{7}{8}$
3rd Quarter	.1750	.1575	$25\frac{1}{2}$	$22\frac{7}{8}$
4th Quarter	.1750	.1575	$28\frac{5}{8}$	$24\frac{3}{8}$
	$.6600	$.5950		
1987				
1st Quarter	$.1350	$.1225	$29\frac{3}{8}$	$24\frac{1}{2}$
2nd Quarter	.1350	.1225	$29\frac{1}{2}$	23
3rd Quarter	.1550	.1400	$37\frac{3}{4}$	$26\frac{3}{8}$
4th Quarter	.1550	.1400	$37\frac{5}{8}$	$20\frac{3}{4}$
	$.5800	$.5250		

* NYSE-Composite Quotations for Common Stock by calendar quarter.

Return on Average Stockholders' Equity

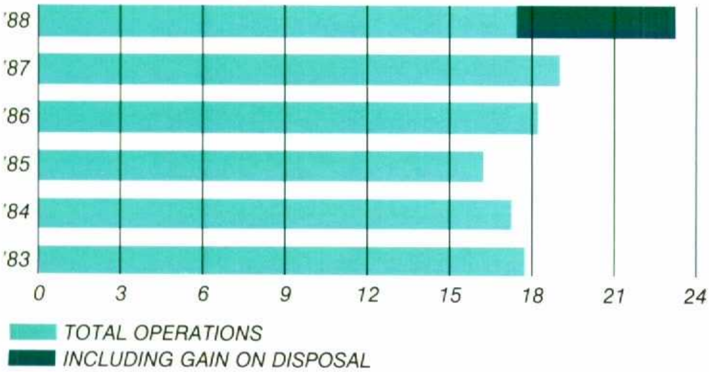
The Corporation's return on average stockholders' equity over the most recent six-year period has ranged from 16.2% in 1985 to 23.3% in 1988 (17.5% before the gain on the sale of Friendly). Excluding the gain on the sale of Friendly, the highest annual return on average stockholders' equity during the last six years was 19.0% in 1987.

Return on Average Invested Capital

The Corporation's return on average invested capital over the most recent six-year period has ranged from 12.7% in 1985 to 17.3% in 1988 (13.3% before the gain on the sale of Friendly). Excluding the gain on the sale of Friendly, the highest annual return on average invested capital during the last six years was 13.8% in 1983. Average invested capital consists of the annual average of beginning and ending balances in long-term debt, deferred income taxes and stockholders' equity. Earnings on invested capital is the sum of net income and the after-tax effect of interest on long-term debt.

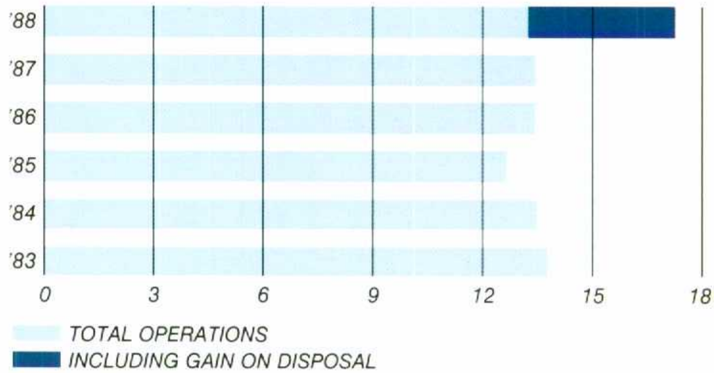
RETURN ON AVERAGE STOCKHOLDERS' EQUITY

(percent)



RETURN ON AVERAGE INVESTED CAPITAL

(percent)



CONSOLIDATED STATEMENTS OF INCOME

(in thousands of dollars except per share amounts)

For the years ended December 31,	1988	1987	1986
Net Sales	**$2,168,048**	$1,863,816	$1,635,486
Costs and Expenses:			
Cost of sales	**1,326,458**	1,149,663	1,032,061
Selling, general and administrative	**575,515**	468,062	387,227
Total costs and expenses	**1,901,973**	1,617,725	1,419,288
Income from Continuing Operations before Interest and Income Taxes	**266,075**	246,091	216,198
Interest expense, net	**29,954**	22,413	8,061
Income from Continuing Operations before Income Taxes	**236,121**	223,678	208,137
Provision for income taxes	**91,615**	99,604	100,931
Income from Continuing Operations	**144,506**	124,074	107,206
Discontinued Operations:			
Income from discontinued operations (net of income taxes of $11,209, $21,627, and $27,138 in 1988, 1987, and 1986, respectively)	**16,063**	24,097	25,558
Gain on disposal of discontinued operations (net of income taxes of $30,821)	**53,380**	—	—
Net Income	**$ 213,949**	$ 148,171	$ 132,764
Income per Share:			
Continuing Operations	**$ 1.60**	$ 1.38	$ 1.15
Discontinued Operations	**.18**	.26	.27
Disposal of Discontinued Operations	**.59**	—	—
Net Income	**$ 2.37**	$ 1.64	$ 1.42

Cash Dividends Paid per Share of Common Stock	**$ .6600**	$ .5800	$ .5200
Cash Dividends Paid per Share of Class B Common Stock	**.5950**	.5250	.4716
Income from Continuing Operations before Interest and Income Taxes as a Percentage of Net Sales	**12.3%**	13.2%	13.2%
Income from Continuing Operations as a Percentage of Net Sales	**6.7%**	6.7%	6.6%

The notes to consolidated financial statements are an integral part of these statements.

Net Sales

Net sales grew $304.2 million or 16% in 1988 and $228.3 million or 14% in 1987. The sales increases represented a combination of growth from acquisitions, increased sales volume of established brands and new product introductions. While selling prices in total increased only slightly during the two-year period, selling prices for pasta products rose significantly in 1988 to cover escalating durum wheat costs. The 1987 sales increase was partly offset by a sales decrease due to a change in accounting method for Petybon, a Brazilian manufacturer of pasta, biscuits and margarine products, that was wholly-owned by the Corporation prior to December 15, 1986. On that date, the Corporation entered into a joint venture agreement under which Petybon was combined with another Brazilian company. Accordingly, the Corporation discontinued the use of the consolidation method and adopted the equity method of accounting for Petybon in December 1986. Therefore, only 1986 net sales include Petybon sales.

Costs and Expenses

Cost of sales as a percentage of sales declined from 63.1% in 1986 to 61.7% in 1987 and 61.2% in 1988. The decrease in 1987 reflects lower raw material costs, particularly for cocoa beans. In 1988, raw material costs were relatively stable, although durum wheat costs increased dramatically due to the severe drought in that year. Contributing to the decreases in both 1988 and 1987 were certain acquired confectionery brands, which have higher gross margins than existing brands, and manufacturing efficiencies.

Selling, general and administrative expenses as a percent of net sales rose from 23.7% in 1986 to 25.1% in 1987 and 26.5% in 1988. Increases in selling and marketing expenses primarily reflect the effect of business acquisitions during the past three years, as well as higher expenditures in support of existing brands, new product introductions, and specific advertising and promotional programs designed to increase sales and enhance market share. General and administrative expenses increased partly as a result of acquisitions.

Interest Expense, Net

Net interest expense increased by $7.5 million in 1988 following a $14.4 million increase in 1987, principally due to debt issued in 1987 and 1986 relating to business acquisitions and the Corporation's purchase and retirement of 3,825,000 shares of its Common Stock in November 1986. The increase in 1988 also reflects higher levels of short-term borrowings to meet seasonal working capital requirements.

Provision for Income Taxes

As a result of the Tax Reform Act of 1986, which reduced the Federal statutory corporate income tax rate from 46% in 1986 to 40% in 1987 and to 34% in 1988 and subsequent years, the Corporation's effective income tax rate on income from continuing operations decreased from 48.5% in 1986 to 44.5% in 1987 and to 38.8% in 1988.

Income from Continuing Operations

Income from continuing operations increased $20.4 million or 16% in 1988 following a $16.9 million or 16% increase in 1987. Income from continuing operations as a percent of net sales (continuing operations margin) was 6.7% in both 1988 and 1987, and 6.6% in 1986. While gross profit margins have improved since 1986 and the effective income tax rate has declined, the continuing operations margin has remained relatively stable as a result of the Corporation's investment in marketing programs and the integration of acquired businesses. These investments are reflective of the Corporation's efforts toward its strategic objective of being market share leader in its North American markets.

Income Per Share — Continuing Operations

The weighted average number of outstanding shares of Common Stock and Class B Stock used to compute per share amounts was 90,186,336 in 1988 and 1987, and 93,508,322 in 1986. The decrease in weighted average shares outstanding in 1987 reflects the Corporation's purchase and retirement of 3,825,000 shares of its Common Stock in November 1986. This transaction favorably impacted income from continuing operations per share, particularly in 1987 and 1988.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of dollars)

For the years ended December 31,	1988	1987	1986
Cash Flows Provided from (Used by) Operating Activities			
Income from continuing operations	$ 144,506	$ 124,074	$ 107,206
Adjustments to reconcile income from continuing operations to net cash flows from continuing operations:			
Depreciation and amortization	51,897	40,389	32,901
Deferred income taxes	4,884	(15,346)	21,927
Changes in assets and liabilities, net of effects from business acquisitions:			
Accounts receivable-trade	(18,207)	(44,148)	18,781
Inventories	6,250	(20,536)	(25,118)
Accounts payable	7,514	27,386	1,302
Other assets and liabilities	9,335	21,785	6,851
Other, net	11,854	2,835	7,438
Net cash flows provided from continuing operations	218,033	136,439	171,288
Net cash flows provided from (used by) discontinued operations	6,187	22,718	(15,617)
Net Cash Flows Provided from Operating Activities	224,220	159,157	155,671
Cash Flows Provided from (Used by) Investing Activities			
Capital additions	(101,682)	(68,504)	(74,452)
Business acquisitions	(284,540)	(161,610)	(102,388)
Sale of Friendly Ice Cream Corporation	375,000	—	—
Tax effect of gain on sale of Friendly Ice Cream Corporation	(30,821)	—	—
Other, net	(8,455)	(4,529)	(2,239)
Net Cash Flows Used by Investing Activities	(50,498)	(234,643)	(179,079)
Cash Flows Provided from (Used by) Financing Activities			
Net increase (decrease) in short-term debt	(25,463)	25,463	(4,815)
Long-term borrowings	713	104,338	99,561
Repayment of long-term debt	(4,769)	(14,244)	(3,637)
Repayment of assumed debt	(23,371)	—	(21,403)
Cash dividends paid	(58,530)	(51,467)	(48,146)
Purchase of the Corporation's Common Stock	—	—	(86,904)
Net Cash Flows Provided from (Used by) Financing Activities	(111,420)	64,090	(65,344)
Increase (Decrease) in Cash and Cash Equivalents	62,302	(11,396)	(88,752)
Cash and Cash Equivalents at January 1	7,771	19,167	107,919
Cash and Cash Equivalents at December 31	$ 70,073	$ 7,771	$ 19,167
Interest Paid (Continuing Operations)	$ 29,555	$ 20,493	$ 8,507
Income Taxes Paid (Continuing Operations)	$ 84,902	$ 108,613	$ 76,631

The notes to consolidated financial statements are an integral part of these statements.

In 1988, the Corporation adopted the provisions of Statement of Financial Accounting Standards No. 95, "Statement of Cash Flows" (FAS No. 95), and restated previously reported statements of changes in financial position for 1987 and 1986. While FAS No. 95 did not materially change the Corporation's format for reporting, it impacted the classification of cash flows among categories. The consolidated statements of cash flows reconcile income from continuing operations to cash flows from operating activities, and show the relationship among operating, investing and financing activities.

Summary

The Corporation used cash provided from operating activities principally to finance capital additions and dividends in 1988. Cash proceeds from the sale of Friendly, net of taxes on the gain on disposal, were used to repay short-term debt incurred in financing the acquisition of Peter Paul/Cadbury, short-term seasonal borrowings, and debt assumed as part of the acquisition.

Operating Activities

Operating activities include both continuing and discontinued operations. Depreciation and amortization have increased significantly as a result of continuous investment in capital additions and business acquisitions. Cash requirements for accounts receivable and inventory have tended to fluctuate during the three-year period based on sales during December and inventory management practices. Over the past three years, cash provided from continuing operations was $525.8 million and has exceeded cash requirements for capital additions and dividend payments during that period by $123.0 million.

The Corporation's cash provided from continuing operations during the year is affected by seasonal sales patterns. Chocolate and confectionery seasonal and holiday related sales are typically highest during the third and fourth quarters of the year, representing the principal seasonal effect, while pasta sales are slightly higher during the cooler weather periods. Generally, the Corporation's domestic seasonal working capital needs peak during the summer months.

Cash flows provided from discontinued operations reflect income from discontinued operations, adjusted for changes in net assets of discontinued operations during each year presented.

Investing Activities

Investing activities reflect capital additions, business acquisitions and, in 1988, the disposition of Friendly. Capital additions during the past three years included manufacturing equipment, expansion of existing facilities and construction of distribution facilities. Cash used for business acquisitions reflects current assets, property, plant and equipment and intangibles acquired, net of liabilities assumed. Businesses acquired during the past three years include Peter Paul/Cadbury in 1988, the Canadian Confectionery Operation in 1987 and Luden's in 1986. The gross proceeds from the disposition of Friendly were reduced by income taxes on the gain on the sale.

Financing Activities

Financing activities include debt borrowings and repayments, payment of dividends, and the purchase of the Corporation's Common Stock in 1986. In each of the past three years, domestic short-term borrowings in the form of commercial paper or short-term commercial bank borrowings were required to fund seasonal working capital requirements. Additionally, interim short-term debt was incurred to partially finance business acquisitions in each year and the purchase of the Corporation's Common Stock in 1986. In 1988, cash proceeds from the sale of Friendly were used to repay short-term borrowings used to finance the Peter Paul/Cadbury acquisition, short-term seasonal borrowings and debt assumed as part of the acquisition. In 1987, the increase in short-term debt reflected the use of short-term borrowings to partially finance the acquisition of the Canadian Confectionery Operation.

Cash provided from the issuance of long-term debt in 1987 and 1986 was used principally to repay, in whole or part, the short-term debt incurred to finance business acquisitions in those years, repay debt assumed as part of these acquisitions and finance the purchase of the Corporation's Common Stock from its majority stockholder, Hershey Trust.

Repayments of long-term debt principally represent scheduled payments and, in 1987, the repurchase of sinking fund debentures.

Cash dividends increased 14% in 1988 over 1987 and totalled $158.1 million over the three year period. This represents an average of 29% of cash flows provided from operating activities and is in line with the Corporation's current payout target of approximately one-third of income from operations.

CONSOLIDATED BALANCE SHEETS

(in thousands of dollars)

December 31,	1988	1987
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 70,073	$ 7,771
Accounts receivable — trade (less allowances for doubtful accounts of $8,373 and $5,072)	166,789	121,528
Inventories	308,755	263,156
Prepaid expenses and other	73,480	54,387
Net assets of discontinued operations	—	275,123
Total current assets	619,097	721,965
Property, Plant and Equipment, Net	736,012	564,472
Intangibles Resulting from Business Acquisitions	371,286	226,067
Investments and Other Assets	38,270	31,850
	$1,764,665	$1,544,354
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 128,786	$ 108,003
Accrued liabilities	144,326	102,672
Accrued income taxes	17,394	16,414
Short-term debt and current portion of long-term debt	54,875	29,684
Total current liabilities	345,381	256,773
Long-term Debt	233,025	280,900
Other Long-term Liabilities	47,964	43,135
Deferred Income Taxes	132,429	131,136
Total liabilities	758,799	711,944
Stockholders' Equity:		
Common Stock, $1 par value, outstanding shares: 74,907,032 in 1988; 74,889,450 in 1987	74,907	74,889
Class B Common Stock, $1 par value, outstanding shares: 15,279,304 in 1988; 15,296,886 in 1987	15,279	15,297
Additional paid-in capital	50,779	51,285
Cumulative foreign currency translation adjustments	20,581	2,038
Retained earnings	844,320	688,901
Total stockholders' equity	1,005,866	832,410
	$1,764,665	$1,544,354

The notes to consolidated financial statements are an integral part of these balance sheets.

Assets

Total assets increased $220.3 million or 14% at December 31, 1988, primarily due to the acquisition of Peter Paul/Cadbury and capital expenditures for property, plant and equipment.

Current assets of continuing operations increased $172.3 million at December 31, 1988, reflecting an improved cash position and increased inventory levels as a result of the Peter Paul/Cadbury acquisition. Trade accounts receivable also increased due to strong sales of confectionery and pasta products in December 1988.

Capital additions totaled $101.7 million in 1988 and $68.5 million in 1987. The Peter Paul/Cadbury acquisition in 1988 increased property, plant and equipment by $118.9 million. In 1987, the acquisition of the Canadian Confectionery Operation added $30.5 million. Retirements during both years included the disposal of certain assets acquired through business acquisitions in 1986 and 1987. Depreciation expense for 1988, 1987 and 1986 amounted to $43.7 million, $35.4 million and $31.3 million, respectively. At December 31, 1988, the Corporation's principal capital commitments included the installation of manufacturing equipment and expansion of existing facilities.

The increase in intangibles resulting from business acquisitions principally reflects the Peter Paul/Cadbury acquisition.

Liabilities

Total liabilities increased $46.9 million or 7% at December 31, 1988, primarily due to increases in accounts payable and accrued liabilities, partially offset by the repayment of short-term borrowings in 1988.

Accounts payable and accrued liabilities both reflect increases due to the Peter Paul/Cadbury acquisition. Accounts payable was also impacted in 1988 by increased deliveries of certain packaging and raw materials at year-end.

Total debt decreased $22.7 million at December 31, 1988. The Corporation had no short-term borrowings at December 31, 1988, compared with $25.5 million at December 31, 1987. The increase in current portion of long-term debt and decrease in long-term debt at December 31, 1988 reflect the reclassification to current of $50.0 million of notes issued in 1986, which are payable in November 1989. Bank lines of credit which may be borrowed directly or used to support the issuance of commercial paper were $100 million at December 31, 1988.

Total taxes payable, consisting of accrued income taxes and deferred income taxes, rose slightly in 1988, primarily reflecting higher income, including the gain on disposal of discontinued operations, substantially offset by the decrease in the effective income tax rates.

The Federal deferred income tax liability at December 31, 1988 and 1987, has been provided based upon Federal statutory corporate income tax rates in effect at the time of the underlying transactions. The Financial Accounting Standards Board has issued Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes" (FAS No. 96). Among other changes, FAS No. 96 provides for recording deferred income taxes at tax rates in effect when temporary differences are expected to reverse, and adjustment of deferred income tax balances when statutory corporate income tax rates are increased or reduced. Upon adoption, the Corporation has the option to record the entire adjustment in the year of adoption or retroactively restate prior years.

Adoption of FAS No. 96 is required no later than 1990, although earlier implementation is permitted. The Corporation has not decided in which year it will implement the change, nor has it decided which option it will utilize. However, management believes that based on the current Federal statutory income tax rate, either method, when adopted, will have a favorable impact on net income.

Stockholders' Equity

Stockholders' equity rose 21% in 1988 and has increased at a compound rate of 11% over the past five years.

Cumulative foreign currency translation adjustments increased substantially at December 31, 1988, reflecting the impact of the Canadian dollar. The Canadian dollar has strengthened from approximately $.769 U.S. at the end of 1987 to approximately $.838 U.S. at year-end 1988.

Liquidity Measures

The continuing operations ratio of current assets to current liabilities was 1.8 : 1 at December 31, 1988 and 1.7 : 1 at December 31, 1987. The Corporation's capitalization ratio was 22% at December 31, 1988 and 27% at December 31, 1987. The decrease in 1988 primarily reflects lower short-term debt combined with an increase in stockholders' equity.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands of dollars)

	Common Stock	Class B Common Stock	Additional Paid-In Capital	Cumulative Foreign Currency Translation Adjustments	Retained Earnings	Total Stockholders' Equity
Balance at January 1, 1986	$26,236	$ 5,101	$54,006	$ (8,579)	$651,135	$727,899
Net income					132,764	132,764
Dividends—Common Stock and Class B Common Stock					(48,146)	(48,146)
Foreign currency translation adjustments				2,456		2,456
Conversion of Class B Common Stock into Common Stock	1	(1)				—
Three-for-one stock split	52,474	10,200			(62,674)	—
Purchase and Retirement of Common Stock	(3,825)		(2,197)		(80,882)	(86,904)
Incentive plan distribution			(128)			(128)
Balance at December 31, 1986	74,886	15,300	51,681	(6,123)	592,197	727,941
Net income					148,171	148,171
Dividends—Common Stock and Class B Common Stock					(51,467)	(51,467)
Foreign currency translation adjustments				8,161		8,161
Conversion of Class B Common Stock into Common Stock	3	(3)				—
Incentive plan distribution			(396)			(396)
Balance at December 31, 1987	74,889	15,297	51,285	2,038	688,901	832,410
Net income					213,949	213,949
Dividends—Common Stock and Class B Common Stock					(58,530)	(58,530)
Foreign currency translation adjustments				18,543		18,543
Conversion of Class B Common Stock into Common Stock	18	(18)				—
Incentive plan distribution			(506)			(506)
Balance at December 31, 1988	$74,907	$15,279	$50,779	$20,581	$844,320	$1,005,866

The notes to consolidated financial statements are an integral part of these statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Significant accounting policies employed by the Corporation are discussed below and in Notes 8, 9, 11 and 12. As described in Note 3, the Corporation sold Friendly Ice Cream Corporation in 1988. Accordingly, the financial statements and notes below have been restated for discontinued operations for all periods presented.

In 1988, the Corporation adopted the provisions of the Statement of Financial Accounting Standards No. 95, "Statement of Cash Flows," and restated previously reported statements of changes in financial position for 1987 and 1986.

Principles of Consolidation

The consolidated financial statements include the accounts of the Corporation and its subsidiaries after elimination of intercompany accounts and transactions. Investments in affiliated companies are accounted for on the equity method.

Cash Equivalents

All highly liquid debt instruments purchased with a maturity of three months or less are classified as cash equivalents.

Commodities Futures Contracts and Options

In connection with the purchasing of major commodities (principally cocoa and sugar) for anticipated manufacturing requirements, the Corporation enters into commodities futures contracts and options as deemed appropriate in order to reduce the risk associated with future price increases. These futures contracts and options are accounted for as hedges, and, accordingly, gains and losses are deferred and recognized in cost of sales as part of the product cost.

Property, Plant and Equipment

Property, plant and equipment is stated at cost. Depreciation of buildings and machinery and equipment is computed using the straight-line method over the estimated useful lives.

Intangibles Resulting from Business Acquisitions

Intangible assets resulting from business acquisitions principally consist of the excess of the acquisition cost over the fair value of the net assets of businesses acquired (goodwill). Goodwill is amortized on a straight-line basis over periods not exceeding 40 years. Other intangible assets are amortized on a straight-line basis over their estimated useful lives. The increase during 1988 was primarily the result of the acquisition of the operating assets of the U.S. confectionery business of Cadbury Schweppes Inc. and Cadbury Schweppes plc.

Accumulated amortization of intangible assets resulting from business acquisitions was $14,812,000 and $6,977,000 at December 31, 1988 and 1987, respectively.

Foreign Currency Translation

For foreign entities, results of operations are translated using the average exchange rates during the period. Assets and liabilities are translated to U.S. dollars using the exchange rates in effect at the balance sheet date. Resulting translation adjustments are recorded in a separate component of stockholders' equity, "Cumulative Foreign Currency Translation Adjustments." For foreign entities operating in highly inflationary economies, nonmonetary assets and liabilities are translated at historical exchange rates and related translation gains and losses are included in results of operations. Foreign exchange gains and losses included in the consolidated statements of income were not material.

License Agreements

The Corporation has entered into license agreements under which it has access to proprietary technology and manufactures and/or markets and distributes certain products. The Corporation's rights under these agreements are extendable on a long-term basis at the Corporation's option subject to certain conditions, including minimum sales levels. License fees and royalties, payable under the terms of the agreements, are expensed as incurred.

2. ACQUISITIONS

On August 25, 1988, the Corporation acquired from Cadbury Schweppes Inc. and Cadbury Schweppes plc (Cadbury) certain assets and liabilities of Cadbury's U.S. confectionery business (Peter Paul/Cadbury) for $284.5 million, plus the assumption of $30 million in debt. The amount paid includes a $14.5 million adjustment paid during the fourth quarter based upon determination of certain actual asset and liability balances as of August 25, 1988. In addition, the parties entered into trademark and technology license agreements under which the Corporation manufactures and/or markets and distributes in the United States, Cadbury's confectionery brands, including *Peter Paul Mounds, Peter Paul Almond Joy, York* peppermint pattie and the *Cadbury* label items including *Dairy Milk, Fruit & Nut, Caramello,* and *Creme Eggs*. The Corporation also has the right to manufacture, market and distribute certain brands outside of the United States.

In June 1987, the Corporation acquired the assets and trademark rights of Nabisco Brands Ltd.'s Canadian confectionery and snack nut businesses (Canadian Confectionery Operation) for $161.6 million. The Corporation also assumed certain long-term debt. The businesses acquired include bar candy sold under the brands *Oh Henry!* and *Lowney*, hard roll candy sold under the brand names *Life Savers* and *Breath Savers*, peanuts and other nuts sold under the brand name *Planters*, chocolate chips sold under the *Chipits* brand name, boxed chocolates sold under the *Moirs* brand name and gum and chewy candy sold under the *Care*Free* and *Bubble Yum* brands. The *Care*Free* and *Bubble Yum* business and brands were sold by the Corporation in 1988. The sales price approximated the Corporation's investment.

In October 1986, the Corporation acquired the capital stock of The Dietrich Corporation for approximately $102 million plus an amount equal to acquired cash and short-term investments. The acquired operations consist of Luden's, maker of *Luden's* throat drops, *5th Avenue* candy bar and *Mello Mint* peppermint patties, and Queen Anne, a producer of chocolate covered cherries.

The following table presents the fair value of the tangible and intangible assets acquired and the liabilities assumed for the acquisitions in each year presented:

For the years ended December 31,	1988	1987	1986
(in thousands of dollars)			
Assets acquired	**$356,565**	$174,339	$144,216
Liabilities assumed, including debt	**(72,025)**	(12,729)	(41,828)
Cash paid	**$284,540**	$161,610	$102,388

The above acquisitions were accounted for as purchases, and accordingly, results subsequent to the dates of acquisition are included in the consolidated financial statements. Had the acquisition of Peter Paul/Cadbury occurred at the beginning of each period and the Canadian Confectionery Operation occurred at the beginning of 1987, pro forma consolidated results would have been as follows:

For the years ended December 31,	1988	1987
(in thousands of dollars except per share amounts)	*(unaudited)*	
Net sales	**$2,311,085**	$2,208,691
Income from continuing operations	**129,689**	104,019
Net income	**199,132**	128,116
Income from continuing operations per share	**1.44**	1.15
Net income per share	**2.21**	1.42

The pro forma results are based on historical financial information provided by Cadbury and Nabisco Brands Ltd., as adjusted to give effect to certain costs and expenses, interest expense and income taxes which would have been incurred by the Corporation if it had owned and operated Peter Paul/Cadbury and the Canadian Confectionery Operation throughout the periods presented. These results are not necessarily reflective of the actual results which would have occurred if the acquisitions had been completed at the beginning of each year, nor are they necessarily indicative of future combined financial results.

3. DIVESTITURES

On September 2, 1988, the Corporation sold all of the issued and outstanding capital stock of Friendly Ice Cream Corporation (Friendly), a wholly-owned subsidiary of the Corporation. The total amount received for said securities, a covenant not to compete and a trademark license was $375.0 million. Net sales for Friendly were $393.2 million, $572.4 million and $536.5 million for the eight months in 1988 and the years 1987 and 1986, respectively.

In December 1986, the Corporation formed a joint venture in Brazil with the Bunge Born Group. Under the joint venture agreement, a Brazilian pasta unit of the Bunge Born Group was combined with Petybon. Petybon, a producer of pasta, biscuits and margarine products, was a 100% owned subsidiary of the Corporation prior to the joint venture agreement. The Corporation retained a 45% equity interest in the joint venture. Accordingly, the Corporation adopted the equity method of accounting effective December 1986.

In October 1986, the Corporation sold its 22½% interest in Chadler Industrial de Bahia S.A., a cocoa bean processor located in Salvador, Bahia, Brazil. The sales price approximated the Corporation's investment.

4. CAPITAL STOCK AND INCOME PER SHARE

In 1987, the Corporation amended its Restated Certificate of Incorporation to increase the authorized number of shares of capital stock from 230,000,000 to 530,000,000. At December 31, 1988, of the authorized shares of capital stock, 450,000,000 shares were designated as Common Stock, 75,000,000 shares as Class B Common Stock (Class B Stock), and 5,000,000 shares as Preferred Stock, each class having a par value of one dollar per share.

The Common Stock and the Class B Stock generally vote together without regard to class on matters submitted to stockholders, including the election of directors, with the Common Stock having one vote per share and the Class B Stock having ten votes per share. However, the Common Stock, voting separately as a class, is entitled to elect one-sixth of the Board of Directors. With respect to dividend rights, the Common Stock is entitled to cash dividends 10% higher than those declared and paid on the Class B Stock.

Shares of the Class B Stock were issued in a one-time-only exchange offer to Common Stock holders on a share-for-share basis in late 1984. Class B Stock can be converted into Common Stock on a share-for-share basis at any time. During 1988, 17,582 shares of Class B Stock were converted into Common Stock, and during 1987, 3,000 shares of Class B Stock were converted into Common Stock. At December 31, 1988, there was a combined total of 90,186,336 shares of both classes outstanding. No shares of the Preferred Stock were issued or outstanding.

Hershey Trust Company, as Trustee for Milton Hershey School (Hershey Trust), as institutional fiduciary for estates and trusts unrelated to Milton Hershey School, and as direct owner of investment shares, held a total of 23,420,989 shares of the Common Stock, and, as trustee for Milton Hershey School, held 15,153,003 shares of the Class B Stock at December 31, 1988, and is entitled to cast approximately 77% of the total votes of both classes of the Corporation's common stock. In 1988, the Corporation amended its Restated Certificate of Incorporation to require Hershey Trust's approval prior to the issuance of shares of Common Stock, or other action which would result in Hershey Trust not continuing to have voting control of the Corporation.

Income per share has been computed based on the weighted average number of shares of the Common Stock and the Class B Stock outstanding during the year (90,186,336 in 1988 and 1987, and 93,508,322 in 1986). The decrease in weighted average shares outstanding reflects the Corporation's purchase of 3,825,000 shares of Common Stock from Hershey Trust in November of 1986. These shares were retired and became authorized but unissued shares of Common Stock.

5. INTEREST EXPENSE

Interest expense, net consisted of the following:

For the years ended December 31,	1988	1987	1986
(in thousands of dollars)			
Long-term debt	**$27,288**	$21,566	$10,514
Short-term debt	**8,093**	3,436	3,314
Capitalized interest	**(3,318)**	(1,720)	(2,603)
	32,063	23,282	11,225
Interest income	**(2,109)**	(869)	(3,164)
	$ 29,954	$22,413	$ 8,061

6. SHORT-TERM DEBT

The Corporation maintained lines of credit arrangements with commercial banks, under which it could borrow up to $100 million at December 31, 1988 and $150 million at December 31, 1987 at the lending banks' prime commercial interest rates or lower. These lines of credit, which may be used to support commercial paper borrowings, may be terminated at the option of the banks or the Corporation. There were no borrowings under these lines of credit or outstanding commercial paper borrowings at December 31, 1988. At December 31, 1987, the Corporation had outstanding commercial paper borrowings of $55,463,000 against its supporting lines of credit, of which $30,000,000 was classified as long-term debt as discussed in Note 7.

Lines of credit are supported by commitment fee arrangements. The fees range up to ⅜% per annum of the commitment. There were no compensating balance agreements which legally restrict these funds. However, as a result of borrowings, during 1987 the Corporation maintained balances of up to 3¾% of commitments under these lines of credit.

The average outstanding balance of short-term debt in 1988 and 1987 was $101,600,000 and $45,132,000, respectively, with a weighted average interest rate of 7.6% and 7.0%, respectively. Domestic borrowings under lines of credit and commercial paper in both years were used to fund seasonal working capital requirements and provide interim financing for business acquisitions. Maximum short-term borrowings at any month-end were $472,484,000 and $117,748,000 in 1988 and 1987, respectively.

As a result of maintaining a consolidated cash management system, the Corporation maintains overdraft positions at certain banks. Such overdrafts, which are included in accounts payable, were $28,917,000 and $29,125,000 at December 31, 1988 and 1987, respectively.

7. LONG-TERM DEBT

Long-term debt at December 31, 1988 and 1987 consisted of the following:

December 31,	1988	1987
(in thousands of dollars)		
8.7% Senior Notes due 1988–1992	**$ 8,000**	$ 10,000
7.0% Notes due 1989	**50,000**	50,000
Medium-Term Notes, 8.45% to 9.92% (average rate 9.13%), due 1990–1998	**100,000**	100,000
7.25% Sinking Fund Debentures due 1997	**1,023**	1,023
9.5% Sinking Fund Debentures due 2009	**56,250**	56,250
9.125% Sinking Fund Debentures due 2016	**50,000**	50,000
Other obligations, net of unamortized debt discount	**22,627**	17,848
	287,900	285,121
Less—current portion	**54,875**	4,221
Total long-term debt	**$233,025**	$280,900

On June 30, 1987, the Corporation entered into a Distribution Agreement relating to the issuance and sale of up to $100,000,000 aggregate principal amount of Medium-Term Notes (the Notes) under the Corporation's registration statement filed April 18, 1986, pursuant to Rule 415 of the Securities Act of 1933, as amended. As of December 31, 1987, $70,000,000 of the Notes had been issued. In February 1988, the Corporation issued the remaining $30,000,000 of the Notes. The proceeds from issuance of the Notes were used to partially repay commercial paper notes and other borrowings which had been issued to finance the acquisition of the Canadian Confectionery Operation. At December 31, 1987, $30,000,000 of commercial paper then outstanding was classified as long-term debt and included as Medium-Term Notes in the above table.

Aggregate annual maturities and sinking fund requirements, net of repurchased debentures and excluding unamortized debt discount, are: 1989, $54,943,000; 1990, $18,280,000; 1991, $22,191,000; 1992, $26,517,000; and 1993, $7,419,000.

8. INCOME TAXES

The provision for Federal and state income taxes is based on income from continuing operations before income taxes as reported in the consolidated statements of income. Income taxes relating to discontinued operations are included in the "Income from Discontinued Operations" and "Gain on Disposal of Discontinued Operations" in the consolidated statements of income. Investment and other tax credits are recognized as a reduction in the provision using the flow-through method.

Deferred income taxes are provided to reflect timing differences between reported results of operations for financial statement and income tax purposes. Timing differences relate primarily to accelerated depreciation, commodities futures contracts and employee benefit plan contributions. In 1987, the Corporation modified its tax treatment of certain insurance, marketing and employee benefit expenses. While these expenses continue to be recognized currently for financial statement purposes, the Corporation now deducts such amounts for income tax purposes when paid. This change necessitated a cumulative adjustment which served to increase the current provision for income taxes with an offsetting decrease in the deferred provision in 1987. The provision for income taxes on income from continuing operations was as follows:

For the years ended December 31, *(in thousands of dollars)*	**1988**	1987	1986
Current	**$ 86,731**	$114,950	$ 79,004
Deferred	**4,884**	(15,346)	21,927
Provision for income taxes	**$ 91,615**	$ 99,604	$100,931

The following table reconciles the provision for income taxes with the amount computed by applying the Federal statutory rate:

For the years ended December 31,	**1988**		1987		1986	
(in thousands of dollars)	**Amount**	**%**	Amount	%	Amount	%
Income taxes computed at statutory rate	**$80,281**	**34.0**	$89,471	40.0	$ 95,743	46.0
Increase (reduction) resulting from:						
State income taxes, net of Federal income tax benefits	**10,704**	**4.5**	9,142	4.1	8,577	4.1
Investment tax credit	—	—	(214)	(.1)	(1,865)	(.9)
Nondeductible acquisition costs	**1,988**	**.9**	1,629	.7	383	.2
Other	**(1,358)**	**(.6)**	(424)	(.2)	(1,907)	(.9)
Provision for income taxes	**$91,615**	**38.8**	$99,604	44.5	$100,931	48.5

The Tax Reform Act of 1986 (the Act) reduced the Federal statutory corporate income tax rate from 46% to 40% for the calendar year 1987 and to 34% for subsequent years. Additionally, the Act retroactively eliminated investment tax credits for capital investments initiated subsequent to December 31, 1985. The reductions in the Corporation's effective income tax rates in 1987 and 1988 are due to the reduction in the Federal statutory corporate income tax rate.

The Financial Accounting Standards Board has issued Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes" (FAS No. 96). FAS No. 96 accounting and disclosure rules must be adopted no later than 1990 although earlier implementation is permitted. The Corporation has not implemented the new standard. When the Corporation does adopt the new accounting rules, it may record the entire catch-up effect in the year of adoption or it may retroactively restate prior financial statements. The Corporation has not decided which option it will utilize or in which year it will implement the change. However, management believes that based on the current Federal statutory corporate income tax rate, either method, when adopted, will have a favorable impact on net income.

9. RETIREMENT PLANS AND OTHER BENEFITS

The Corporation and its subsidiaries sponsor a number of defined benefit retirement plans covering substantially all employees. Plans covering salaried employees provide retirement benefits based on career average or final pay compensation as defined within the provisions of the individual plans, while plans covering hourly employees generally provide benefits based on years of service. The Corporation's policy is to fund the normal cost plus amounts required to amortize actuarial gains and losses and prior service costs over periods ranging from 15 to 30 years. Plan assets are invested in a broadly diversified portfolio consisting primarily of domestic and international common stocks and fixed income securities. The Corporation also participates in several multiemployer retirement plans which provide defined benefits to employees covered under certain collective bargaining agreements.

In the fourth quarter of 1987, the Corporation adopted Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions," for its Canadian plans. The effect was immaterial.

The following is a summary of consolidated pension expense:

For the years ended December 31, *(in thousands of dollars)*	**1988**	1987	1986
Corporate sponsored pension plans:			
Domestic	**$ 6,729**	$ 5,706	$ 6,256
Canadian	**990**	593	221
Multiemployer plans	**1,122**	1,025	558
Other	**366**	305	274
Total pension expense	**$ 9,207**	$ 7,629	$ 7,309

Pension expense for the domestic and Canadian plans for 1988 and 1987 and the domestic plans for 1986 included the following components:

For the years ended December 31, *(in thousands of dollars)*	**1988**	1987	1986
Service cost (benefits earned during the period)	**$ 10,260**	$ 9,134	$ 7,666
Interest cost on projected benefit obligation	**17,659**	16,102	14,363
Investment return on plan assets	**(27,332)**	(15,488)	(26,309)
Net amortization and deferral	**7,132**	(3,449)	10,536
Corporate sponsored pension plans	**$ 7,719**	$ 6,299	$ 6,256

The following table sets forth the funded status and amounts recognized in the consolidated balance sheets for the domestic and Canadian plans at December 31, 1988 and 1987:

	December 31, 1988		December 31, 1987	
(in thousands of dollars)	**Assets Exceed Accumulated Benefits**	**Accumulated Benefits Exceed Assets**	Assets Exceed Accumulated Benefits	Accumulated Benefits Exceed Assets
Actuarial present value of:				
Vested benefit obligation	**$159,384**	**$10,347**	$157,073	$ 6,290
Accumulated benefit obligation	**$175,754**	**$11,237**	$169,234	$ 8,753
Actuarial present value of projected benefit obligation	**$214,354**	**$17,563**	$201,743	$ 15,923
Plan assets at fair value	**242,700**	**1,153**	214,263	1,962
Plan assets greater than (less than) the projected benefit obligation	**28,346**	**(16,410)**	12,520	(13,961)
Net (gain) loss unrecognized at date of transition	**(2,508)**	**4,944**	(3,601)	5,820
Prior service cost not yet recognized in earnings	**668**	**1**	—	—
Unrecognized net (gain) loss from past experience different than that assumed	**(9,276)**	**4,450**	3,492	2,492
Prepaid pension expense (pension liability)	**$ 17,230**	**$ (7,015)**	$ 12,411	$(5,649)

The projected benefit obligation for the plans was determined using an assumed discount rate of 8.5% in 1988 and 8.25% in 1987. For both years the assumed long-term compensation increase rate was principally 6% and the assumed long-term rate of return on plan assets was 9.5%.

The Corporation and its subsidiaries provide certain health care and life insurance benefits for retired employees. Substantially all of the Corporation's domestic employees become eligible for these benefits at normal retirement age. Retiree health care and life insurance premiums of $2,401,000, $2,005,000 and $2,041,000 were expensed as paid during 1988, 1987 and 1986, respectively.

10. INCENTIVE PLAN

The long-term portion of the 1987 Key Employee Incentive Plan (Plan) provides for grants or awards to key employees of one or more of the following: performance stock units, nonqualified stock options (stock options), stock appreciation rights and restricted stock units. Stock options are granted at exercise prices of not less than 100% of the fair market value of a share of Common Stock at the time the option is granted and are exercisable for periods no longer than 10 years from the date of grant. In 1987, stock options covering 47,150 shares were granted and are exercisable at a price of $28.00 per share. In 1988, stock options for 361,550 shares were granted and are exercisable at an average price of $25.37 per share. None of the stock options from 1987 or 1988 have been exercised or have expired. In 1988, 34,250 stock options were cancelled as a result of employee terminations primarily relating to the sale of Friendly.

As of December 31, 1988, 207,968 contingent performance stock units have been granted for potential future distribution for cycles ending December 31, 1988, 1989 and 1990. The Plan provides for the deferral of performance stock unit awards by participants. Deferred performance stock units and accumulated dividend amounts totaled 343,265 shares at December 31, 1988. No stock appreciation rights or restricted stock units have been granted or awarded.

11. SUPPLEMENTAL BALANCE SHEET INFORMATION

Inventories

The majority of the Corporation's inventories are valued under the last-in, first-out (LIFO) method at amounts that do not exceed realizable values. The remaining inventories are stated at the lower of first-in, first-out (FIFO) cost or market. LIFO cost of inventories valued using the LIFO method was $230,566,000 in 1988 and $197,732,000 in 1987. Total year-end inventories were as follows:

December 31,	**1988**	1987
(in thousands of dollars)		
Raw materials	**$175,588**	$160,753
Goods in process	**31,459**	33,792
Finished goods	**180,595**	149,965
Inventories at FIFO	**387,642**	344,510
Adjustment to LIFO	**(78,887)**	(81,354)
Total inventories	**$308,755**	$263,156

Property, Plant and Equipment

Major classes of property, plant and equipment are as follows:

December 31,	**1988**	1987
(in thousands of dollars)		
Land	**$ 14,821**	$ 16,474
Buildings	**203,775**	177,848
Machinery and equipment	**800,275**	616,030
	1,018,871	810,352
Accumulated depreciation	**282,859**	245,880
	$ 736,012	$564,472

Property, plant and equipment balances include construction in progress in the amount of $58,985,000 at December 31, 1988 and $27,205,000 at December 31, 1987.

Accrued Liabilities

Accrued liabilities are as follows:

December 31,	**1988**	1987
(in thousands of dollars)		
Payroll and other compensation costs	**$ 42,502**	$ 35,639
Advertising and promotional expenses	**44,293**	30,602
Other	**57,531**	36,431
Total accrued liabilities	**$144,326**	$102,672

12. SUPPLEMENTAL INCOME STATEMENT INFORMATION

Supplemental income statement information is provided in the table below. These costs are expensed in the year incurred.

For the years ended December 31,	**1988**	1987	1986
(in thousands of dollars)			
Promotion	**$230,187**	$171,162	$122,508
Advertising	**99,082**	97,033	83,600
Maintenance and repairs	**54,377**	51,464	48,725
Rent expense	**17,618**	14,208	13,270
Research and development	**15,695**	12,985	12,479

Rent expense represents the cost of all operating leases, principally pertaining to certain administrative buildings, distribution facilities and transportation equipment. Future minimum rental payments under noncancelable operating leases with an original term in excess of one year as of December 31, 1988 are: 1989, $5,798,000; 1990, $5,686,000; 1991, $5,212,000; 1992, $4,481,000; 1993, $4,114,000; 1994 and beyond, $127,326,000.

Amounts for taxes other than payroll and income taxes, amortization of intangibles resulting from business acquisitions, and royalties are not presented because such amounts are not material.

13. GEOGRAPHIC SEGMENT INFORMATION

The Corporation operates in a single industry — the manufacture, distribution and sale of consumer foods. The table below presents information about the Corporation's domestic and foreign operations. The foreign amounts presented represent Canadian operations.

For the years ended December 31,	**1988**	1987
(in thousands of dollars)		
Net sales:		
Domestic	**$1,968,647**	$1,739,532
Foreign	**199,401**	124,284
Total	**$2,168,048**	$1,863,816
Income from continuing operations before interest and income taxes:		
Domestic	**$ 256,657**	$ 238,806
Foreign	**9,418**	7,285
Total	**$ 266,075**	$ 246,091
Identifiable assets at December 31:		
Domestic	**$1,506,037**	$1,311,921
Foreign	**258,628**	232,433
Total	**$1,764,665**	$1,544,354

Transfers of product between geographic areas are not significant. In 1986, foreign operations were less than 10% of total net sales, income from continuing operations before interest and income taxes, and assets.

14. QUARTERLY DATA (Unaudited)

The following is a summary of quarterly data for the years 1988 and 1987:

(in thousands of dollars except per share amounts)

Year 1988	**First**	**Second**	**Third**	**Fourth**	**Year**
Net sales	**$495,044**	**$403,112**	**$597,642**	**$672,250**	**$2,168,048**
Gross profit	**193,919**	**155,487**	**228,432**	**263,752**	**841,590**
Income from continuing operations	**36,154**	**20,446**	**41,674**	**46,232**	**144,506**
Income from discontinued operations	**755**	**8,203**	**7,105**	—	**16,063**
Gain on disposal of discontinued operations	—	—	**53,380**	—	**53,380**
Net income	**36,909**	**28,649**	**102,159**	**46,232**	**213,949**
Income from continuing operations per share	**.40**	**.23**	**.46**	**.51**	**1.60**
Net income per share	**.41**	**.32**	**1.13**	**.51**	**2.37**

Year 1987	First	Second	Third	Fourth	Year
Net sales	$467,601	$343,801	$519,012	$533,402	$1,863,816
Gross profit	171,465	133,518	199,123	210,047	714,153
Income from continuing operations	30,063	19,323	38,738	35,950	124,074
Income from discontinued operations	2,831	7,698	9,000	4,568	24,097
Net income	32,894	27,021	47,738	40,518	148,171
Income from continuing operations per share	.33	.22	.43	.40	1.38
Net income per share	.36	.30	.53	.45	1.64

The weighted average number of shares outstanding was 90,186,336 for all periods presented.

RESPONSIBILITY FOR FINANCIAL STATEMENTS

Hershey Foods Corporation is responsible for the financial statements and other financial information contained in this report. The Corporation believes that the financial statements have been prepared in conformity with generally accepted accounting principles appropriate under the circumstances to reflect in all material respects the substance of applicable events and transactions. In preparing the financial statements, it is necessary that management make informed estimates and judgments. The other financial information in this annual report is consistent with the financial statements.

The Corporation maintains a system of internal accounting controls designed to provide reasonable assurance that financial records are reliable for purposes of preparing financial statements and that assets are properly accounted for and safeguarded. The concept of reasonable assurance is based on the recognition that the cost of the system must be related to the benefits to be derived. The Corporation believes its system provides an appropriate balance in this regard. The Corporation maintains an Internal Auditing Department which reviews the adequacy and tests the application of internal accounting controls.

The financial statements have been audited by Arthur Andersen & Co., independent public accountants, whose appointment was ratified by stockholder vote at the stockholders' meeting held on April 25, 1988. Their report expresses an opinion that the Corporation's financial statements are fairly stated in conformity with generally accepted accounting principles, and they have indicated to us that their examination was performed in accordance with generally accepted auditing standards which are designed to obtain reasonable assurance that the financial statements are free of material misstatement.

The Audit Committee of the Board of Directors of the Corporation, consisting solely of outside directors, meets regularly with the independent public accountants, internal auditors and management to discuss, among other things, the audit scopes and results. Arthur Andersen & Co. and the internal auditors both have full and free access to the Audit Committee, with and without the presence of management.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Stockholders and Board of Directors
of Hershey Foods Corporation:

We have audited the accompanying consolidated balance sheets of Hershey Foods Corporation (a Delaware Corporation) and subsidiaries as of December 31, 1988 and 1987, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1988, appearing on pages 22, 24, 26, 28 and 29 through 36. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hershey Foods Corporation and subsidiaries as of December 31, 1988 and 1987, and the results of their operations and cash flows for each of the three years in the period ended December 31, 1988 in conformity with generally accepted accounting principles.

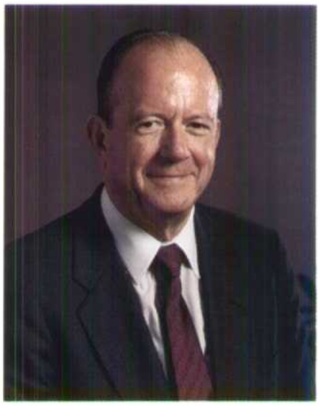
Arthur Andersen & Co.

New York, N.Y.
February 3, 1989

Board of Directors

Richard A. Zimmerman
Chairman of the Board
and Chief Executive Officer

Howard O. Beaver, Jr.
Retired Chairman of the Board
Carpenter Technology Corporation
Reading, Pa.



John F. Burlingame
Retired Vice Chairman of the Boa
and Executive Officer
General Electric Company
Stamford, Conn.

Francine I. Neff
Vice President and Director
NETS Inc.
privately-held investment company
Albuquerque, N.M.

John M. Pietruski
Retired Chairman of the Board
and Chief Executive Officer
Sterling Drug Inc.
Edison, N.J.

H. Robert Sharbaugh
Retired Chairman
and Chief Executive Officer
Sun Company, Inc.
Hilton Head Island, S.C.

Audit Committee
Dr. Sybil C. Mobley, *Chair*
John F. Burlingame
Francine I. Neff
John M. Pietruski

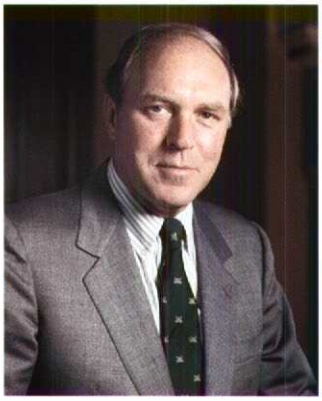
Compensation and Executive Organization Committee
H. Robert Sharbaugh, *Chair*
Howard O. Beaver, Jr.
John F. Burlingame
John C. Jamison
John M. Pietruski

Employee Benefit Committee
John C. Jamison, *Chair*
Howard O. Beaver, Jr.
Kenneth V. Hatt
Dr. Sybil C. Mobley
H. Robert Sharbaugh

Executive Committee
Richard A. Zimmerman, *Chair*
Joseph P. Viviano
Kenneth L. Wolfe

Nominating Committee
Francine I. Neff, *Chair*
Kenneth V. Hatt
Richard A. Zimmerman

Kenneth V. Hatt
Chairman of the Board
Hershey Trust Company
Hershey, Pa.



John C. Jamison
Dean, School of Business Administration
The College of William & Mary
Williamsburg, Va.

Dr. Sybil C. Mobley
Dean, School of Business and Industry
Florida Agricultural and Mechanical University
Tallahassee, Fla.

Joseph P. Viviano
President
Hershey Chocolate U.S.A.

Kenneth L. Wolfe
President and Chief Operating Officer

Division Presidents

William F. Christ
President
Hershey International

David B. Conn
President
Hershey Canada Inc.

C. Mickey Skinner
President
Hershey Pasta Group

Joseph P. Viviano
President
Hershey Chocolate U.S.A.

Executive Offices

100 Mansion Road East
Hershey, Pa. 17033

Corporate Officers

Richard A. Zimmerman
Chairman of the Board and Chief Executive Officer

Kenneth L. Wolfe
President and Chief Operating Officer

William Lehr, Jr.
Senior Vice President and Secretary

Michael F. Pasquale
Senior Vice President and Chief Financial Officer

Kenneth L. Bowers
Vice President
Corporate Communications

Frank Cerminara
Vice President, Corporate Development and Commodities

Charles E. Duroni
Vice President and General Counsel

Sharon A. Lambly
Vice President
Human Resources

Dr. Barry L. Zoumas
Vice President
Science and Technology

Thomas C. Fitzgerald
Treasurer

John B. Stiles
Controller and Chief Accounting Officer

SIX-YEAR CONSOLIDATED FINANCIAL SUMMARY

(all dollars and shares amounts in thousands except market price and per share statistics)

	1988	1987	1986	1985	1984	1983
Summary of Operations[a]						
Net Sales	$ 2,168,048	1,863,816	1,635,486	1,526,584	1,423,396	1,280,379
Cost of Sales	$ 1,326,458	1,149,663	1,032,061	982,370	934,817	844,488
Selling, General and Administrative	$ 575,515	468,062	387,227	345,299	309,587	270,472
Interest Expense, net	$ 29,954	22,413	8,061	10,240	8,325	14,602
Income Taxes	$ 91,615	99,604	100,931	91,910	82,986	70,123
Income from Continuing Operations	$ 144,506	124,074	107,206	96,765	87,681	80,694
Income from Discontinued Operations	$ 16,063	24,097	25,558	22,462	21,001	19,472
Gain (Loss) on Disposal of Discontinued Operations	$ 53,380	—	—	(7,000)	—	—
Net Income	$ 213,949	148,171	132,764	112,227	108,682	100,166
Income Per Share from Continuing Operations[b]	$ 1.60	1.38	1.15	1.03	.93	.86
Net Income Per Share[b]	$ 2.37	1.64	1.42	1.19	1.16	1.07
Weighted Average Shares Outstanding[b]	90,186	90,186	93,508	94,011	94,011	94,011
Dividends Paid on Common Stock	$ 49,433	43,436	40,930	37,386	37,073	34,470
Per Share[b]	$ .660	.580	.520	.475	.413	.367
Dividends Paid on Class B Common Stock	$ 9,097	8,031	7,216	6,556	1,607	—
Per Share[b]	$ .595	.525	.472	.428	.105	—
Income from Continuing Operations as a Percentage of Net Sales	6.7%	6.7%	6.6%	6.3%	6.2%	6.3%
Depreciation	$ 43,721	35,397	31,254	28,348	22,725	18,594
Advertising	$ 99,082	97,033	83,600	77,135	71,070	61,274
Promotions	$ 230,187	171,162	122,508	105,401	94,921	78,773
Payrolls	$ 298,483	263,529	238,742	222,267	208,395	195,254
Year-end Position and Statistics[a]						
Working Capital	$ 273,716	190,069[c]	174,147	225,345	187,642	191,435
Property, Plant and Equipment, net	$ 736,012	564,472	502,241	452,756	430,359	384,320
Capital Additions	$ 101,682	68,504	74,452	61,361	45,258	71,697
Total Assets	$ 1,764,665	1,544,354	1,262,332	1,116,074	1,052,161	920,329
Long-term Debt	$ 233,025	280,900	185,676	86,986	103,155	106,543
Stockholders' Equity	$ 1,005,866	832,410	727,941	727,899	660,928	596,037
Current Ratio	1.8:1	1.7:1[c]	2.0:1	2.4:1	2.1:1	2.6:1
Capitalization Ratio	22%	27%	21%	12%	14%	16%
Net Book Value per Share[b]	$ 11.15	9.23	8.07	7.74	7.03	6.34
Return on Average Stockholders' Equity	23.3%	19.0%	18.2%	16.2%	17.3%	17.8%
Return on Average Invested Capital	17.3%	13.5%	13.5%	12.7%	13.5%	13.8%
Full-time Employees at Year-end	12,100	10,540	10,210	10,380	10,150	9,630
Stockholders' Data						
Outstanding Shares of Common Stock and Class B Common Stock at Year-end[b]	90,186	90,186	90,186	94,011	94,011	94,011
Market Price of Common Stock At Year-end[b]	$ 26	24½	24⅝	17⅛	12⅞	10½
Range During Year[b]	$ 28⅝–21⅞	37¾–20¾	30–15½	18⅜–11⅝	13¾–9⅜	11⅝–8⅛
Number of Common Stock and Class B Common Stock Holders At Year-end	30,430	29,151	23,502	17,529	16,729	16,467

Notes:

[a] All amounts, with the exception of the Return on Average Stockholders' Equity and Return on Average Invested Capital, have been restated for discontinued operations, where applicable.

[b] All shares and per share amounts have been adjusted for the two-for-one stock split effective September 15, 1983 and the three-for-one stock split effective September 15, 1986.

[c] Amounts exclude net assets of discontinued operations.

Hershey Foods Stockholders

As of December 31, 1988, the Corporation had outstanding 74,907,032 shares of Common Stock and 15,279,304 shares of Class B Common Stock owned by 30,430 registered stockholders of record.

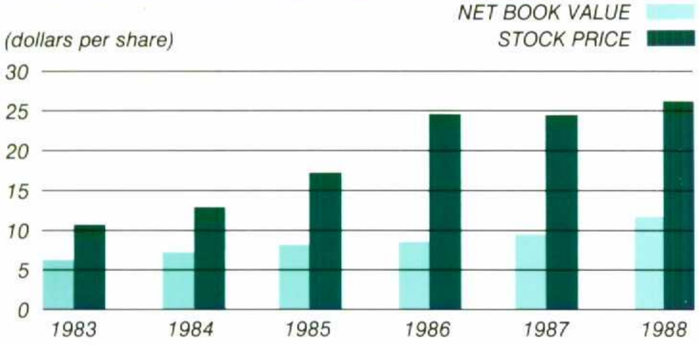
Stock Market Data

Hershey Foods Corporation's Common Stock is listed and traded principally on the New York Stock Exchange under the ticker symbol "HSY." Class B Common Stock is not listed for trading. The stock tables of most financial publications list the Corporation as "Hrshey." Options on Hershey Foods' Common Stock are traded on the American Stock Exchange.

	Common Stock Approximate Share Volume	
Year	**Annual Composite Trading**	**Average Daily**
1988	46,693,000	185,000
1987	48,145,000	190,000
1986	22,838,000	90,000

	Common Stock Price			Dividend	
1988	**High**	**Low**	**Close**	**Common**	**Class B**
(calendar quarter)					
1st	$28⅜	$22⅞	$24¾	$.155	$.1400
2nd	26¼	21⅞	24⅝	.155	.1400
3rd	25½	22⅞	25	.175	.1575
4th	28⅝	24⅜	26	.175	.1575

YEAR-END NET BOOK VALUE & STOCK PRICE



Annual Meeting

The Annual Meeting of Stockholders will be held at 2:00 p.m. on Monday, April 24, 1989, at the Hershey Theatre, East Caracas Avenue (near Cocoa Avenue) in Hershey, Pa.

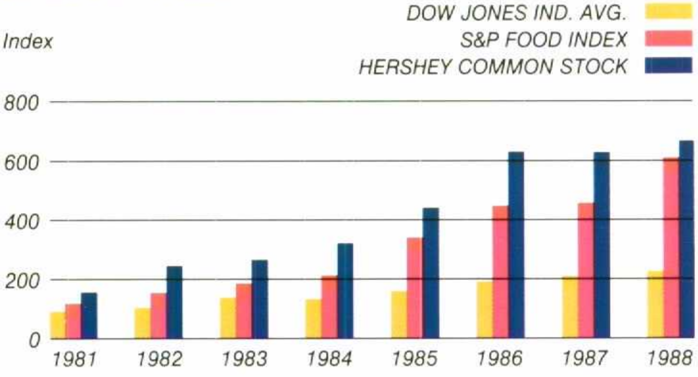
A formal notice of this meeting, together with a proxy statement, is being mailed to stockholders on or about March 8, 1989.

Dividend Policy

Dividends on both the Corporation's Common Stock and Class B Common Stock are declared by the Board of Directors, and are normally paid in the months of March, June, September and December.

The year 1988 marked the 14th consecutive annual increase in the dividend rate. The increase is consistent with the Corporation's current target of paying approximately one-third of earnings in dividends to stockholders. The dividend on the Common Stock to be paid in March 1989 will be the 237th consecutive regular dividend paid by the Corporation.

HERSHEY FOODS COMMON STOCK PERFORMANCE vs. SELECTED INDICES



Indexed as of December 31, 1980.

Automatic Dividend Reinvestment Service

Stockholders may build their investment in Hershey Foods by enrolling in the Corporation's Automatic Dividend Reinvestment Service.

For information, write to the Corporation's Office of the Secretary in Hershey, or the Dividend Reinvestment Department of Manufacturers Hanover Trust Company, P.O. Box 24850, Church Street Station, New York, N.Y. 10242-4850.

Form 10-K

Form 10-K, filed annually in March with the Securities and Exchange Commission, is available without charge from the Office of the Secretary, Hershey Foods Corporation, P.O. Box 814, Hershey, Pa. 17033.

Investor Relations

Hershey Foods maintains an active investor relations program to keep stockholders and the investment community informed of the Corporation's progress.

Comments or requests for information should be directed to the Investor Relations Department at the address listed on page 1.

Hershey Foods Corporation
Hershey, Pennsylvania 17033, U.S.A.